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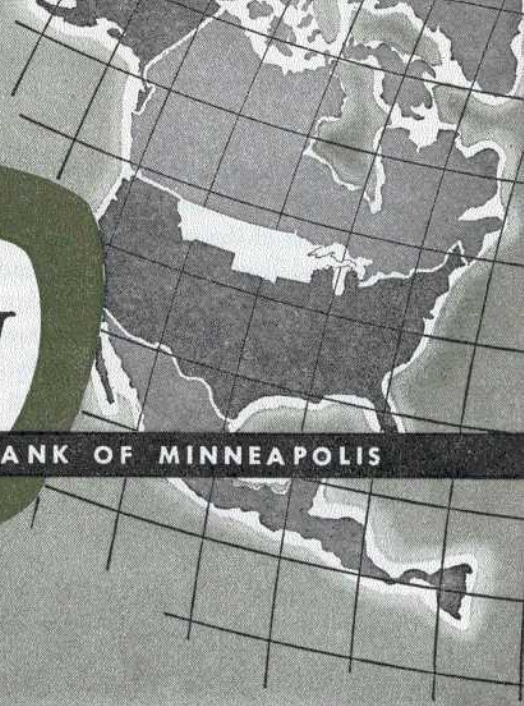


Monthly Review
OF THE FEDERAL RESERVE BANK OF MINNEAPOLIS

Seasonal Upturn Lags

It is now apparent that the seasonal upturn in business activity this fall has not occurred to the usual extent. Business sentiment has been on the cautious side since late summer but it was not until many of the October and November business statistics became available that such sentiment was validated. Total employment, for example, failed to show any advance in October and employment in manufacturing was on the minus side compared with the previous month and the same month a year ago. The number of unemployment claims in October was substantially above that of a year ago but even so unemployment as a percentage of total employment remains at a relatively very low rate. The increase in unemployment claims in this district appears to be centered in western Montana, where shutdowns or slowdowns in lumbering and mining production have been substantial. Department store sales in the district, which usually show a seasonal upturn at this time of the year, have tended to lag somewhat in recent months.

Despite the general slowdown in business activity, there remains one very important and relatively strong element in the district's economy. This is agriculture, where bumper grain crops have been produced and harvested (with the exception of some corn and soybeans, where harvesting has been delayed because of the cool wet fall). Generally higher livestock prices compared with

Enough liquidity?

A discussion of the concept of liquidity and the liquidity position of Ninth district member banks . . . . . see page 7

a year ago also have helped to boost farm income for the first nine months several percentage points above that of the same period in 1956. High level grain and livestock production tends to boost activity in the agricultural processing and handling industries. This is a principal reason why employment has declined relatively little in this district outside the mining and lumbering areas.

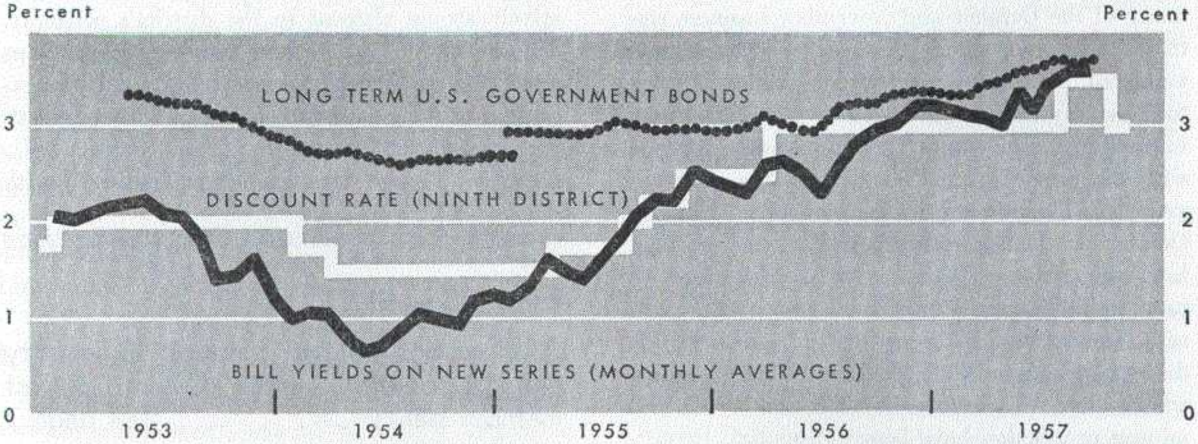
That the district's economy is on the whole in satisfactory condition is indicated by the fact that many business indicators in addition to agricultural income continue to register at favorable levels. In some instances the rate of advance has simply slowed up. Bank debits in October, for example, were slightly higher compared with a year ago, as were the level of bank deposits and average weekly earnings in manufacturing.

The reduction in the discount rate from 3½ to 3 percent at the Federal Reserve Bank of Minneapolis, as well as at all of the other Reserve banks during November, indicates recognition by the monetary authorities that the economy is undergoing moderate readjustments and that inflationary pressures have been reduced.

The easing of inflationary pressures does not necessarily mean that longer range prospects for economic growth and development are threatened or that a serious recession is inevitable. That the boom of recent months was somewhat excessive was indicated by the inflationary price spiral that occurred. It could well be that the adjustment going on at present will help promote a more sustainable kind of growth in the future. Realistically, in our type of economy, recurring adjustments in either direction from time to time are to be expected.

Currently it appears probable that defense spending may be strengthened. If this happens, it will tend to offset to a large extent prospective reductions in business spending. A substantial increase in defense spending could so increase the demand for labor and capital resources that pressure might again occur on the price level. At the moment, however, wholesale prices of all commodities are down about one-half point from the peak of last August and consumer prices leveled off in October for the first time in many months.

Selected money market rates indicate the gradual development of 'tight money' since mid-1954.



The following selected topics describe particular aspects of the district's current economic scene:

CROP OUTLOOK STRONG

Ninth district feed crop prospects have again been revised upward. The November 1 corn crop estimate shows an increase of 1 percent over the October estimate. This places the expected corn crop for the district at 488 million bushels, 4 percent above last year.*

Nationally the picture is also one of abundance. The nation's total feed grain production for 1957 has been estimated at a record of nearly 140 million tons. This is 8 percent over 1956 production and 4 percent over the previous 1948 record. Also, hay stocks are up 10 percent from the 1956 level.

The cool, wet weather of October and early November has slowed the harvest of late crops, but has not dampened expectations of high total crop output. By November 15, corn picking was nearly half completed in the district. The adverse weather conditions have also slowed the drying of the crop. Much of the harvested crop is in danger of damage from heat and molds. A large share of the crop will have to be mechanically dried or fed to livestock before warm weather if it is to be used.

Feeder cattle up in price

Farmers who want to feed the soft corn are finding that they must pay more for feeder cattle this year. Also, because of large feed supplies and excellent pasture conditions in range areas this year, feeder cattle have been moving to market later and at heavier weights than was the case in 1956. Although feeder cattle prices are higher, the prospects for profits as forecast by the U. S. Department of Agriculture are about average. The higher feeder cattle prices are being offset by declining feed prices. Other favorable indications are the smaller volume of slaughter and higher prices for fed cattle expected in 1958.

The declining feed prices brought about by a large feed supply have coincided with rising prices for meat animals in 1957. This has resulted in very favorable current livestock-feed price ratios which are expected to induce livestock expansion in the period ahead.

*Includes Minnesota, North Dakota, South Dakota and Montana.

LOAN INCREASE SLOWS

Condition reports submitted by our member banks for the October 11 call date this year provide an opportunity to observe trends in the principal types of loans. The figures indicate that not only did total loans increase by less in the year ended October 11 than in the previous year but each of the four major categories of loans, exclusive of commodity credit corporation loans, did likewise. Owing chiefly to the more rapid growth of time deposits in the most recent twelve month period, the ratio of loans to total deposits was unchanged despite the addition to loans.

October 11 call report loan data for Ninth district member banks.

(millions of dollars)

	Oct. 11 1957	Oct. 26 1956	Oct. 5 1955
Commercial and industrial loans	$677	$629	$555
Loans to farmers*	245	226	234
Real estate loans	564	532	486
Other loans	542	500	453
Total loans	2,028	1,887	1,728
Total deposits	4,427	4,095	4,108
C.C.C. loans under (*) above	32	20	39
Loans as percent of deposits	46%	46%	42%

CURRENT BANKING DEVELOPMENTS

Loans of district member banks, exclusive of loans to banks, fell $16 million in October; in the same month last year such loans rose $4 million. The increase of deposits in October this year amounted to less than half the increase reported a year earlier.

At the city banks commercial and industrial loans fell $23 million or $8 million more than the decline registered in October last year. Real estate loans rose $3 million while all other loans declined $1 million. The addition to real estate loans is the largest for a month since February of 1956.

Deposits of city banks, up $51 million in October 1956, were down $5 million in October this year. Deposits of individuals, partnerships and corporations rose $26 million but withdrawals from other accounts, particularly balances owing to banks, more than offset this increase.

Loans and deposits of country banks rose by $5 million and $54 million, respectively, in October this year. Respective gains in the same month last year were $17 million and $58 million. Loans and deposits at both city and country banks in the district were thus less buoyant in October than a year earlier.

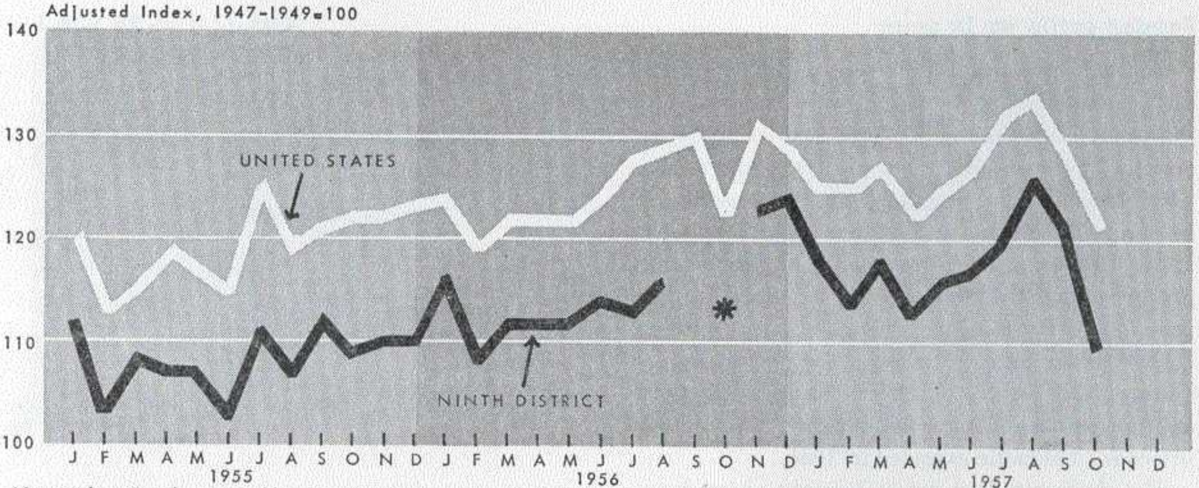
RETAIL SALES HAVE WEAKENED

Last summer consumer expenditures were among the strongest sectors of the economy. In the nation, retail sales in July and August were 7 percent and 6 percent respectively above the receipts for the same months in 1956. Sales were equally strong in the Ninth district. Sales at retail stores in the Ninth district as measured by the Bureau of the Census' sample (which excludes sales of large retail chains) in July and August were 15 percent and 8 percent respectively above the year ago figures.

In past weeks much uncertainty has surrounded the retail sales picture. The most important development may be the decline in personal income. In September, personal income in the nation at a seasonally adjusted annual rate declined to $346.6 billion—a decrease of $200 million from August. In October, it declined further by an even billion dollars. This is the first decline in almost a year.

The increase in unemployment and a shorter work week in some manufacturing firms are probably connected with depressed sales in certain localities in this district. Frequent news of a weak stock market has caused some people to become more conservative. According to a few trade re-

Department store sales index shows downturn this fall.



*September-October monthly average plotted at asterisk.

ports, Asian flu may have depressed over-all sales.

These developments have already weakened sales. In the nation as a whole, total sales, seasonally adjusted, declined nearly 1 percent from August to September. According to the advance report issued by the U. S. Department of Commerce, they declined another 2 percent in October. Sales of retail stores in the Ninth district as measured by the Bureau of the Census' sample (which excludes sales of large retail chains) were only 3 percent above the year ago volume whereas in August they were up 7 percent.

District department store sales have lost some strength this fall. The adjusted index, with 1947-49 level equal to 100 percent, in September was at 121 percent and in October declined to 110 percent. In the four large district cities—Minneapolis, St. Paul, Duluth and Superior—weekly sales in the first two weeks of November fell below the corresponding dollar volume of a year ago.

The sale of automobiles is very important in the general business picture. If the 1958 models attract consumers and sell well, a number of industries, other than automobile manufacturers, will have a firm floor under the demand for their products. At the middle of November, it was too early to draw definite conclusions on the trend of 1958 model car sales. In the nation, new car deliveries in the first ten days of November were slightly over 10 percent above a year ago. About 45 percent of the sales still were 1957 models. In many communities they were sold at greatly reduced prices. Consequently, the test of consumer interest in 1958 models is yet to come.

In this district, the sale of new cars has been strong in some communities and weak in others. In the Twin City metropolitan area, registrations in October were about 4 percent above a year ago. In the first 13 business days in November, registrations were 17 percent higher than in the same number of days last year.

At this time of year, the percentage change figures from a year ago have less validity than usual. This year virtually all 1958 models were available at dealers showrooms by November 9 while last year new models were available at an earlier date. On the other hand, at the end of the immediate past model year dealers had a substantially larger stock of 1957 models. It is difficult to assess what influence these variables may have had on sales.

SAVINGS BOND DRIVE

Minnesota banks are planning a Savings Bond drive from December 5 through December 15, which will be known as 'B' week. Plans for the promotion were formulated by the Savings Bond committee of the Minnesota Bankers Association.

This promotion is endorsed by the American Bankers Association and has been whole-heartedly supported by banks at the national, state and local levels. The Savings Bond committee recognized special importance of bank promotion of the sale of U. S. Savings Bonds in Minnesota, since 75 percent of the bonds sold in this state are purchased at banks.

The newly appointed Under-Secretary of the Treasury for Monetary Affairs, Julian B. Baird, recently wrote to more than 18,000 banks and branches in the country suggesting that bankers can help hold down inflation by encouraging thrift, personal savings in all forms and the sale of more U. S. Savings Bonds. The letter concludes, "I am convinced that every bit of effort we put in Savings Bond promotion as a part of a broad thrift program will be richly rewarded in the contribution we shall be making to the good health of our economy in this critical period."

The Minnesota program will be carried out with the help of newspapers, radio and television, as well as by in-bank promotion.

NATIONAL BUSINESS CONDITIONS

From the National Summary of Business Conditions released by the Board of Governors November 15, 1957.

CONSTRUCTION. Private housing starts in October were at a seasonally adjusted annual rate of one million units. For six consecutive months starts have been around this figure. Value of new construction activity advanced somewhat to a seasonally adjusted annual rate of $48.3 billion. Such outlays have been rising since midyear, reflecting increases in private residential building and in some fields of public construction. Industrial construction has declined appreciably from the record level maintained from mid-1956 through May of this year.

EMPLOYMENT. Employment in nonfarm establishments declined somewhat further in October, reflecting mainly reductions in manufacturing industries. At a seasonally adjusted level of 52.5 million, nonfarm employment was 300,000 below the record level of August, but about 140,000 above October of last year. Weekly earnings of factory workers dropped by about $1.00, to $82.16, reflecting a half-hour reduction in the average workweek. Unemployment changed little from September, but was moderately higher than a year ago.

COMMODITY PRICES. The general level of wholesale commodity prices was relatively stable from mid-October to mid-November. Prices of feed grains declined but livestock and meats recovered somewhat. Average prices of industrial commodities changed little in this period, although some basic materials continued to decline. Steel scrap was down sharply further, and there were decreases in tin, rubber and cotton textiles.

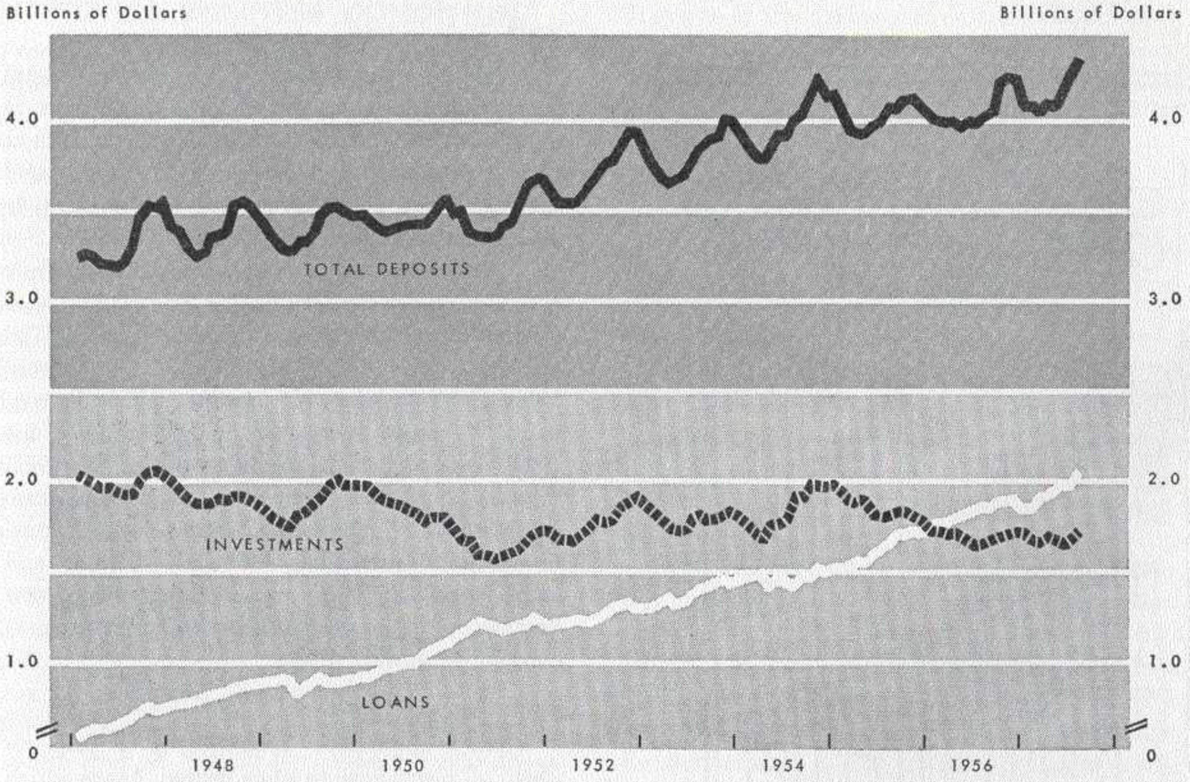
Consumer prices rose very slightly further in September. (The consumer index in October was identical with that of September.) Decreases in some fresh foods were more than offset by continuing advances in some other goods and services.

INDUSTRIAL PRODUCTION. The Board's seasonally adjusted index of industrial production in October was 142 percent of the 1947-49 average, two points below September and four points below a year ago. Output of durable goods and minerals declined further, while activity in the nondurable goods industries was maintained at the record September level. Utility output of electricity declined slightly but remained above the year-ago level.

Steel mill operations decreased contraseasonally in October, by one point, to 81 percent of capacity. In early November, the operating rate fell to 78 percent and ingot production was about one-fifth below a year ago. Production of construction materials was reduced in October, reflecting cutbacks in clay and glass products as well as in lumber. Activity in industries manufacturing producers' equipment generally declined further and was about 8 percent below the spring peak. Auto assemblies were curtailed in October, in part by work stoppages, but production schedules for November indicate a marked recovery from the reduced levels of the September-October change-over period. Television and furniture output continued to decline.

Over-all activity in nondurable goods industries was maintained, despite small reductions indicated in output of textile, apparel and rubber products. Mineral production declined as output of coal and metals declined further.

Chart I—Loans and deposits have grown relatively more than investments at Ninth district member banks in the last 11 years.



drawal of deposits, a bank may first use its cash and cash-like assets to pay depositors' claims, but ultimately it may be necessary to obtain funds by selling *secondary reserves*. Secondary reserves are short-term loans and investments with active markets.

To plan on meeting deposit withdrawals by liquidating secondary reserves carries less risk of loss than to plan on liquidating loans and investments with distant maturities. Risks of loss are reduced by owning short-term securities since changes in interest rates on related types of investments have less effect on the value of short-term investments than on long-term investments. By far the most important type of secondary reserve is that reserve made up of short-term government securities.

Highly liquid earning assets have characteristics that make them attractive to many bank and non-bank investors. Therefore, their yields are typically small with respect to other investments. But the amount of secondary reserves needed for liquidity purposes is normally much less than the funds available for investment, and therefore, banks also invest in higher yielding loans and investments. Such investments as instalment loans, term loans, most business loans, and investments in bonds yield more than do secondary reserves but the risk of selling them at a loss is greater. A banker must weigh the alternatives of income and safety. He must allow for unexpected cash needs in the operation of his business.

Even though capital is not an asset, it is related to liquidity requirements. Like any other business, a bank's total assets equal its liabilities and capital accounts. Therefore, if a bank's capital accounts increase, its deposits and its liquidity needs will be smaller relative to its total assets, and a smaller proportion of highly liquid assets to total assets can then satisfy liquidity requirements.

Federal Reserve credit and liquidity

There is really no complete answer to the question of how best to avoid risk in managing earning assets. For this reason, among others, the Federal Reserve System was created to provide liquidity for earning assets of banks during periods of liquidity need. An individual bank might need cash because of a sudden loss of deposits or because of a sharp growth in the legitimate credit needs of its customers. In such cases the Federal Reserve System can help a bank through a period of unusual need for cash by discounting the bank's note secured by government securities, eligible commercial and agricultural paper or other assets. However, most individual bank liquidity needs are satisfied by the simple process of selling securities to other investors or by timing the maturities of investments so that securities come due when cash is needed. A single bank can usually manage its assets without outside assistance.

Even though a single bank can normally sell a sound security or loan without a severe discount, the entire banking system cannot sell such assets without forcing down values sharply. The problem of liquidity for the entire banking system is not the same as the problem for each individual bank. During periods when there is a general reduction in demand deposits, for example as the result of large currency withdrawals, a 'liquidity crisis' can be precipitated by all banks being forced to sell assets at once. In this case the Federal Reserve can make assets more liquid by discounting notes of member banks as well as by purchasing securities. This ability to bail out the banking system was greatly bolstered by banking legislation during the 1930's which liberalized the definition of eligible paper, permitted the Federal Reserve to acquire additional types of assets, and added government securities to the gold and eligible paper collateral for Federal Reserve Notes.

The Federal Reserve System has, in the past, made the entire banking system liquid as was true during the period of support of government security prices during World War II and up to the Treasury-Federal Reserve Accord in March 1951. Except for the threat of withdrawal of Federal Reserve support, all government security holdings were made highly liquid. Thus, banks could get extra funds for the purpose of making loans or meeting withdrawals by selling 'governments' at their support prices.

Federal Reserve banks can and do play an important part in determining the liquidity of assets held by banks, but the fact that many banks suffer losses when they have occasion to sell assets below book value indicates that there is still no liquidity panacea. The availability of Federal Reserve credit should not prompt banks to ignore predictable cash needs in the management of their earning assets.

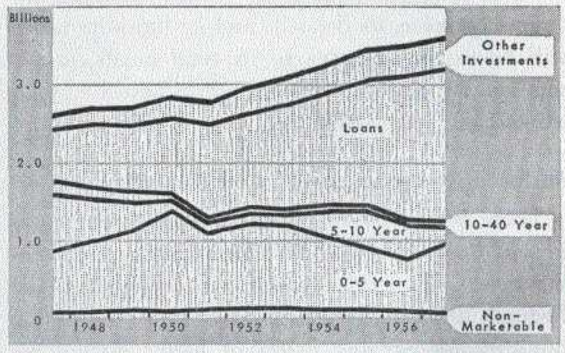
Liquidity of member banks in the Ninth District

Table 1 contains data from 11 post-war June call reports. The table includes June figures for deposits, loans and capital, as well as the government debt holdings of Ninth district banks. Holdings of 'governments' are classified into nonmarketable and marketable debt. Then marketable debt is divided into debt coming due within 5 years, between 5 and 10 years, between 10 and 20 years, and over 20 years. The divisions are wide and therefore no really precise conclusions can be drawn.

The holdings of government securities due in five years or less roughly measures the secondary reserve component of earning assets held by Ninth district banks. During the period since 1947 marketable 'governments' due in five years or less increased by $800 million to $1,300 million in 1950. After 1950 short-term 'governments' fell to $700 million in 1956 and rose again to $900 million in June of this year.

Non-marketable securities are not strictly comparable with marketable securities. Non-marketable debt cannot be sold to another buyer, but can either be redeemed or exchanged for other 'governments.' With the exception of Treasury Bonds, Series B-1975-80, non-marketable debt which has been held for at least six months can be redeemed after one months notice for an amount specified in advance. Redemption values may fall by more than 7 percent of initial cost. The Series B-1975-80 bonds cannot be transferred, marketed, or redeemed, but they can be exchanged for 1.5 percent Treasury Notes due in five years. As recently as August 1957, Treasury Notes due March 1, 1962 and paying a 1.5 percent rate were selling at a discount of more than 10 percent. This discount corresponds to that of some bonds with greater than five year maturity. Holdings of non-marketable federal debt by district member banks increased from 1947 to 1949 but had fallen back to about the 1947 level in June 1957.

Chart 2—Changes in composition of assets at Ninth district member banks from 1947 to 1957



Banks now hold a greater quantity of highly liquid government securities than in 1947. But liquidity requirements have grown too. The growth in liquidity needs is shown by the nearly 30 percent increase in deposits since 1947. Since liquidity needs are related to potential demands on banks by depositors, the ratio of the most liquid category of debt ('governments' due in less than five years) to deposits gives a very rough measure of liquidity with respect to liquidity needs. Chart 2 shows the downward trend in this

Table I—Maturity of government securities held by Ninth district member banks.

(000,000's)

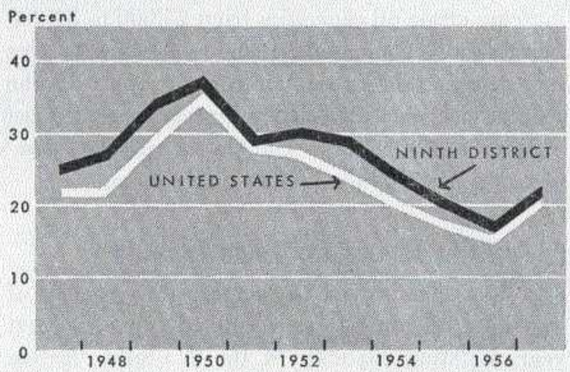
June Call Report	0-5 years	5-10 years	10-20 years	20-40 years	Non-marketable federal debt	Total deposits	Total loans	Capital accounts
6-30-47	799	712	120	67	68	3,209	665	189
6-30-48	906	535	109	43	79	3,353	813	197
6-30-49	1,122	249	109	30	102	3,344	857	209
6-30-50	1,275	147	34	29	96	3,414	976	220
6-30-51	969	135	33	22	125	3,383	1,196	233
6-30-52	1,098	132	42	21	127	3,646	1,227	244
6-30-53	1,085	121	56	1	128	3,714	1,354	258
6-30-54	942	329	56	1	120	3,919	1,461	275
6-30-55	786	478	59	2	122	3,989	1,612	296
6-30-56	676	434	59	3	96	4,011	1,842	316
6- 6-57	909	221	62	2	64	4,155	1,937	332

liquidity ratio in recent years. Liquid assets have failed to keep pace with the growth in deposits. In 1947 the ratio of these liquid assets to deposits was .25. The ratio increased to .37 in 1950, even though loans were increasing rapidly during the period. Since 1950 the strong demand for loans resulted in a shift from 'governments' to loans. The ratio fell to .17 in June 1956 and it increased to .22 in June 1957 but it was still lower than for any postwar year before 1955.

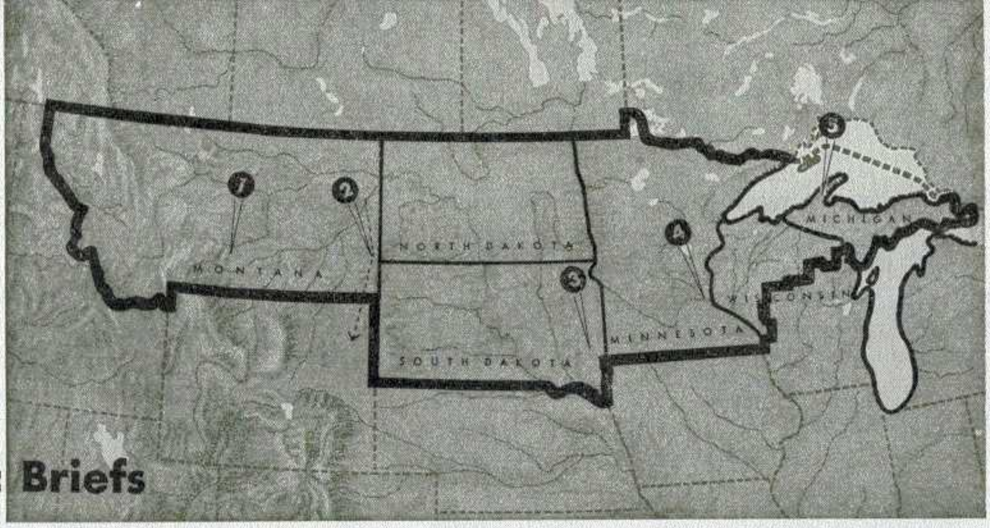
Are district banks adequately protected against the contingency of deposit contraction? No one answer to this question is absolutely correct but an indication of liquidity trends is given by the information in Table 1. The table shows that growth in capital accounts as well as shortening of the maturity structure of bank-held federal debt tended to make banks more liquid, while sharp increases in loans tended to make them less liquid. The $1,300 million increase in loans dwarfs the $50 million increase in highly liquid 'governments.' The capital change is large relative to capital accounts, but the deposit increase in just the last year is greater than the increase in capital for the entire decade.

Chart 2 shows that not only have highly liquid 'governments' increased but the maturity of all federal debt held by banks has shortened. The relatively illiquid 'governments' due in over 20 years have almost completely vanished from the investment portfolios of Ninth district banks. The sharp decrease in these bonds in 1953 occurred largely because of the fact that bonds due in 1972 shifted from the 'over 20 years' to the '10 to 20 years' category. In June 1957 less than 1 percent of government security holdings were to mature in 20 years or more. The dollar amount of 'governments' maturing in between 10 and 20 years is now only 5 percent of all 'governments,' down from 7 percent in 1947. Maturities between five and ten years have shown the steepest decline, falling from 40 percent in 1947 to 18 percent in 1957. The total dollar amount of securities maturing in over five years has decreased absolutely from $900 million in June 1947 to $300 million in June 1957 and relatively from 53 percent of marketable debt held by district banks to 24 percent in June 1957. Despite this decrease in longer term bond holdings, governments maturing in less than five years now represent a smaller proportion of deposits than was true in 1947. It is true that a similar trend has occurred in the rest of the nation. The close correspondence of the liquidity ratio in the United States as a whole and in the district is shown by Chart 3.

Chart 3—'Governments' due in less than 5 years as a percent of deposits at member banks



Banks need liquid assets in order to reduce the risk of loss in the event that assets must be sold. In our district, the shortening maturity of bank-held government debt has tended to increase liquidity, but not enough to match decreases caused by loan expansion. High-liquidity asset holdings have not increased as rapidly as deposits. Do these facts add up to the conclusion that assets owned by banks in the district are not liquid enough? No, the conclusion is simply that district member banks are apparently not in quite as liquid a position as they were a decade ago.



Economic Briefs

1. Billings refinery to expand

Expansion of the Carter Oil refinery plant at Billings, Montana is scheduled for completion by early summer of 1958. The enlargement project will involve revamping of existing equipment to increase crude oil capacities from 25,000 to 34,000 barrels daily. Increased jet fuel requirements, plus increasing needs for asphalt in connection with the federal and state highway programs prompted the expansion of facilities. The Carter refinery, completed in 1949, is the largest in Montana.

2. Boost in Montana pipeline capacity

A $500,000 project to increase the capacity of the Butte oil pipeline is scheduled for early next year. Existing capacity of the 315-mile pipeline from Baker to Fort Laramie, Wyoming, is about 49,000 barrels of oil a day. The expansion program will increase that figure to about 65,000 barrels a day. Major improvements will largely be at the Baker pump station where a new 40,000 barrel storage tank and two suction booster pumps will be installed. Shell Oil Company is majority owner of the pipeline and Shell Pipe Line Corporation operates the line.

3. NSP may build S. D. atomic plant

Northern States Power Company has made provisional selection of a site for its proposed atomic power plant and tests are being made to determine the long-term suitability of the area. Location of the plant is to be on the Big Sioux river four miles northeast of Sioux Falls. The plant will be owned and operated by NSP, although 10 other utilities will be associated with the project. The $28 million plant will have 66,000 kilowatt capacity. Negotiations have been completed with the Atomic Energy Commission for a contract to share the costs of the plant. An operating date of 1962 has been set.

4. Mpls.-Moline shutdown at 2 plants

Minneapolis-Moline Company will temporarily close its Minneapolis and Hopkins plants December 20. The shutdown, affecting over 1,000 employees, will last approximately 30 days. Excessive inventories due to less than anticipated sales was named as the reason for the layoff. Sales for the 1957 fiscal year ending November 1 were about $57 million compared with $66 million in 1956. Normal production is expected by January 20.

5. New Houghton-Hancock bridge

Construction of the new $10 million Houghton-Hancock bridge in Michigan is expected to begin soon. The $4 million substructure contract was awarded recently. The four-lane structure will replace the present two-lane bridge spanning Portage Lake between the cities of Houghton and Hancock on U. S. highway 41.