FEDERAL RESERVE BANK OF NEW YORK

ANNUAL REPORT 1959

FEDERAL RESERVE BANK OF NEW YORK

March 8, 1960

To the Member Banks in the
Second Federal Reserve District:

I am pleased to send you our forty-fifth Annual Report, reviewing the 1959 business and financial scene in this country and abroad, and also commenting on some of the developments of the past decade and their implications for the 1960's. The year 1959 is likely to be remembered as the year of the four-month steel strike. Our Report gives considerable attention to the immediate impact of the strike and to the special problems it posed in framing suitable credit policies for an otherwise prosperous economy. The Report also focuses attention on the changing role of the United States in the world economy, forcefully revealed in the sizable balance-of-payments deficits of the past two years. Fortunately, there are signs that the importance of this problem and the related general problem of inflation is receiving wider recognition and that the country is at least making a start on an effective effort to cope with them.

Alfred Hayes

ALFRED HAYES
President

Federal Reserve Bank

of New York

FORTY-FIFTH ANNUAL REPORT

For the Year

Ended

December 31, 1959

Second Federal Reserve District

Contents:

CHARTS

Forty-fifth Annual Report
Federal Reserve Bank of New York

The "Growing Pains" of a High-Consumption Economy

In reaching new heights during 1959, the American economy encountered several fundamental problems that had been in the making through the preceding decade and seemed certain to be of crucial significance in the next. One of these was dramatized by a steel strike, the longest in history, which tugged downward on the economy through half of the year, weakening but not preventing a strong expansion in most industries. Another set of problems, by no means unrelated, was reflected in the record size of the deficit in the United States balance of payments. Despite these strains, gross national product set new records, as indeed had been true in eight out of ten years in the 1950's. And that led to other kinds of questions as the advance in economic activity generated demands for credit which outran available funds, forcing interest rates to levels that had not been seen for three decades. The United States was apparently experiencing the "growing pains" that are inherent in a high-consumption economy characterized by a widely and confidently held expectation of further rapid increases in both income and consumption and by the pressing, but in part conflicting, need to devote a very sizable proportion of national output to investment and defense.

The steel strike made clear, as perhaps never before, the paradox that the drive for higher incomes and higher consumption—the basic incentives upon which a free economy depends to evoke continued growth—can be self-defeating when the procedures for dividing the national income among various groups break down. The strike was, of course, of dominating importance in the events of the year, both because of the production lost in steel and other industries and because of the possible inflationary consequences that might flow from the settlement in this key industry. But, in a broader view, the strike raised searching questions as to the responsibility of the various groups that wield concentrated economic power—in industry, labor, agriculture, and elsewhere.

What should their obligation be, in a competitive market economy, for finding ways of compromising their competing claims upon the income of the economy without gravely damaging the general welfare? Shutdowns such as that experienced in 1959 are a serious drag on the economy. Yet quick and easy public acquiescence to all income demands—whether exerted by labor in the form of wage demands, by business in moving prices up rather than down, or by agriculture through farm support programs—would lead only to quickening pressures on prices, illusory money gains to all but the strongest economic groups, distorted production patterns that would impede or halt economic growth, and a deterioration of the economy's international position. While the problem of inflationary income demands is not unique to the United States, the leading position of this country in the Free World would seem to make it particularly urgent here to find less wasteful and disruptive solutions than those employed in the steel industry in 1959, but without impairing basic freedoms.

A generation that had grown accustomed to a world-wide dollar shortage was disconcerted, even startled, by the appearance for the second year in a row of a very large United States balance-of-payments deficit. And, while the deficit diminished in the second half of the year, it was still large. This would not have seemed a new type of problem to most other countries. Those of Europe, indeed, had been shaping their economic policies around balance-of-payments problems for generations. But with Europe on its feet after the long period of postwar reconstruction, and becoming an aggressive competitor with the United States for markets everywhere, an end had apparently come to the long insulation of the United States from the influence and the "discipline" of the forces at work through the balance of payments. Perhaps the Free World during the 1960's would be approaching a stage in which the vigorous stimulus of open competition, often dampened inside a country, could be reinforced by competition among countries—that is, by the pressures for improved productivity, lower costs, and attractive prices that arise from one need which nations share with individuals, the need of keeping their external receipts in reasonably close balance with their outpayments.

The fact that economic activity expanded strongly during 1959 despite the steel strike was reassuring, but it also posed difficult problems. Following in the wake of the recovery achieved during 1958, the expansion was further evidence, though not of course conclusive, that the economy is sufficiently resilient, so long as recessions are not allowed to cumulate into depression, to bounce back quickly and vigorously from any dip in activity. The record of 1957-59, coming after the experience of two previous postwar recessions, suggested that the decade ahead would be marked by a preponderance of years in which inflationary, rather than deflationary, pressures would be dominant. The same record also suggested that the will to check and reverse even moderate recessions was so strong that the problems of allocating scarce resources in a full-employment economy would be more insistent than ever.

At the same time, the rising trend of interest rates, culminating in the swift advance during 1959, was a signal that demands for credit were tending to run ahead of the willingness of income recipients to forego current consumption. Investment—whether in plant and equipment, or in such forms as housing, better schools, or defense facilities—can ultimately be financed only as the economy foregoes some current consumption, in order to release resources that can be transformed into net additions to the stock of capital. In the final analysis, the real resources to support investment, and thus economic growth, must be provided through real saving. An attempt to prevent interest rates from rising by creating more bank credit—and using it to finance additions to investment that ran well beyond the dimensions of voluntary savings—could not in fact avoid the inescapable identity between real saving and real investment. Such efforts could only mean the use of monetary inflation to force a diversion of real goods from consumption to investment.

As between high interest rates and the paralyzing effect of inflation, whether "creeping" or "galloping", the choice would seem to be clear. Yet, why should the choice have to be made between only these alternatives? Leaving aside the paradox that a continuing inflation, once it got started, would drive interest rates even higher, the developments in 1959 nonetheless raised a troublesome question as to how high interest rates might eventually go if monetary policy were to carry as large a part of the burden of resisting inflation in the decade ahead as it had in the decade just completed. The rise of between ½ and 2 percentage points in almost all rates of interest during 1959, as the credit and capital markets allocated an inadequate supply of savings among insistent demands for credit, was undoubtedly a significant warning signal that undue burdens were already being placed upon monetary and credit policy.

The Federal Reserve System, given the environment, had no choice but to do what it could to defend the economy against the greater and more imminent evil—inflation. But is it necessary in the decade ahead that the Federal Reserve System should have to choose between policies that lead to disturbingly high interest rates, on the one hand, or acquiescence in monetary inflation, on the other? One conspicuous alternative, as a way of raising savings and at the same time reducing pressure on market rates of interest, would be a sizable Treasury surplus, derived from taxes upon an economy operating at high levels of output and employment. Over a long period there has been a tradition in this country that taxes are an evil per se. Of course, taxes that finance unnecessary government expenditures may rightly be regarded as an undesirable burden. But to the extent that they are used to provide for vital government programs and for a surplus which would in effect add to total savings, they should be recognized not as an evil but as a sometimes necessary and desirable alternative to even greater consumer spending.

A sizable Treasury surplus would ease the pressure upon the capital markets and supply the financial and real resources both to support the enlarged private investment needed for balanced economic growth at home and to assist in the progress of underdeveloped countries abroad. Treasury deficits in times of prosperity, on the other hand, as the experience of 1959 amply showed, absorb savings and compete in the capital markets for an already inadequate supply of loanable funds. The record of the 1950's suggests that an important step toward achieving more rapid growth, broad price stability, *and* lower interest rates would be an improved "policy mix"—in which monetary policy would receive increased support from fiscal policy and in which there would be more effective restraints upon abuses in the exercise of concentrated economic power by private groups.

THE AMERICAN ECONOMY IN 1959

A Year of Advance—With Interruption

When 1959 began, the economy was moving forward strongly. Total output in real terms—that is, after allowing for price increases—had already risen sharply from the April 1958 cyclical trough to a level slightly above the pre-recession high. As growth continued during the first half of 1959, recovery blossomed into expansion, and successive new records were set in the output of goods and services and in personal income (see Chart 1).

In mid-July there began what proved to be the longest steel strike ever experienced by the nation. In time the impact of the shutdown began to be felt much beyond the industries closely connected with the production and distribution of

GROSS NATIONAL PRODUCT IN CURRENT AND CONSTANT DOLLARS. GNP, whether measured in current or constant dollars, rose on balance during 1959, despite the interruption of the steel strike.

Note: Seasonally adjusted annual rates.
Source: United States Department of Commerce.

CHART 1

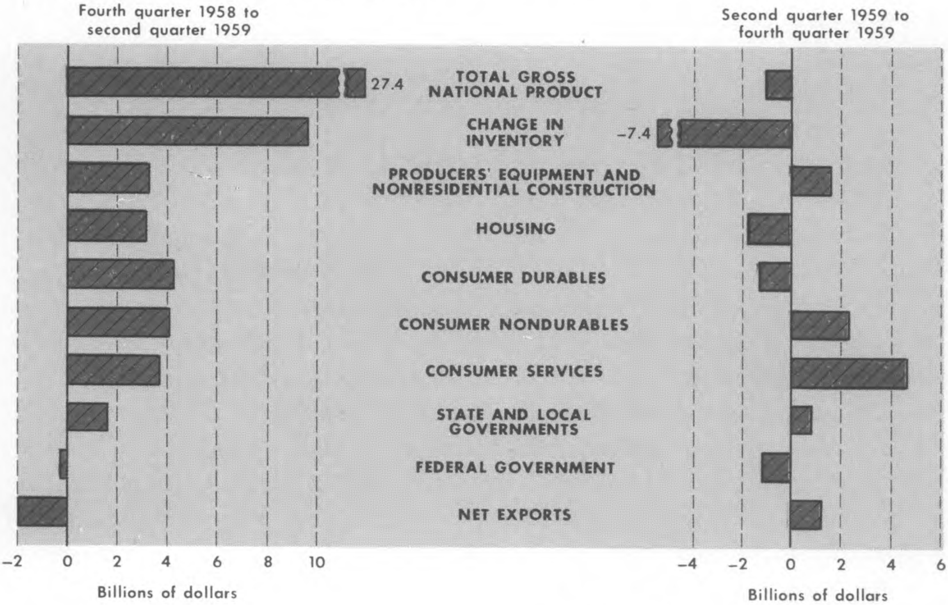
steel, and the downward drift was halted only after the Federal Government obtained a court injunction, which led to the reopening of the struck mills in early November. As steel started to flow again, national output and income resumed their upward course. Thus the year ended, as it had begun, on a buoyant note.

EXPANSION IN BREADTH THROUGH THE FIRST HALF OF THE YEAR. During the first six months of 1959, the economic advance spread to include virtually all types of demand and embraced the business, the consumer, and the government sectors (see Chart 2). The main thrust from the business sector took the form of faster inventory accumulation. Inventories had been rising since the fourth quarter of 1958, but the rate of accumulation continued to accelerate, and in April-June 1959 it was the highest since the Korean war. This build-up of inventories was heavily concentrated in metal-using industries, reflecting precautionary stockpiling in anticipation of midyear strikes in the steel and copper industries. Many other industries also increased their stocks, as orders and sales rose rapidly, but few succeeded in catching up with the growth in demand for their products.

Other types of business investment, which had been lagging during the earlier phase of the cyclical upswing, also rose during the January-June period, although by lesser proportions than investment in inventories. Expenditures for equipment had already started to move upward in late 1958, but spending for new business plant did not begin to rise until early 1959. This lag reflected in part the fact that production facilities had earlier been built up beyond current needs. However, as rising output absorbed idle capacity, investment aimed at increasing capacity also picked up.

Meanwhile, the economic expansion was also being fed by a continuing rise in consumer demand for housing and other goods and services. Private residential construction, one of the principal forces behind the cyclical turn-around in 1958, maintained its strength into the spring of 1959. The peak for such expenditures was reached in May, however. Thereafter, residential outlays subsided, perhaps partly because the preceding record pace had swept through the backlog of prepared projects carried over from the recession, and because some over-all slowing down was inevitable as builders began to test new areas of demand. But a much more conspicuous reason was the rising cost and lessening availability of mortgage credit, reflecting the expansion of other uses for funds that might have

CHANGES IN GROSS NATIONAL PRODUCT AND COMPONENTS. A broad expansion in the first half of 1959 gave way to mixed changes in the second half. The largest shift was in inventories, which were drained away during the steel strike.



Note: Seasonally adjusted annual rates.

CHART 2

Source: United States Department of Commerce.

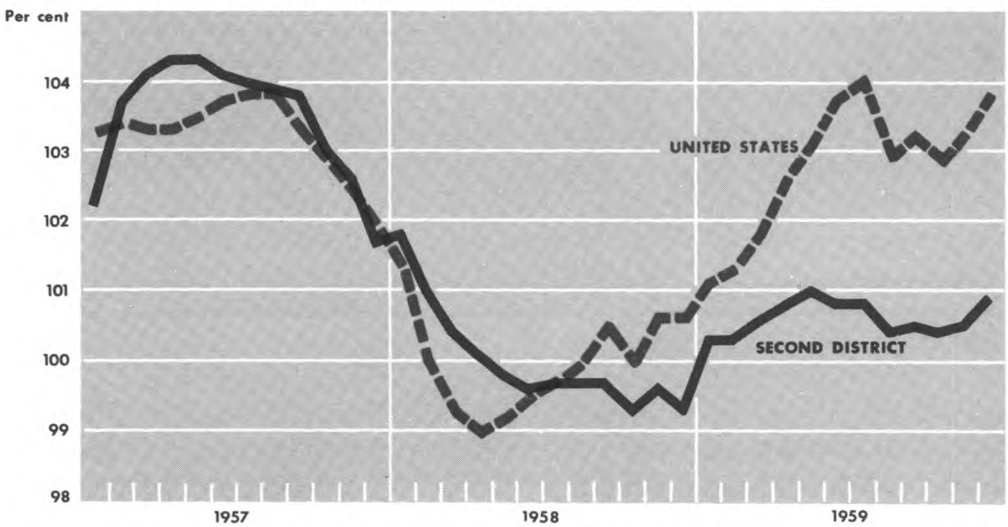
been used in housing.

The rising stream of consumer expenditures for other goods and services was the greatest single growth factor in the January-June period. This demand had declined only very slightly during the 1957-58 recession, as personal income was supported by such "built-in" stabilizers as unemployment insurance. And by the second quarter of 1959, consumption expenditures had advanced to a record annual rate of $311 billion. In real terms, this amounted to 6 per cent more than the peak level achieved before the recession. Taking account of a population increase of almost 5 million in the interim, the per capita advance over this period was, again in real terms, about 3 per cent.

The gains in the economy during the first half of the year were also evident in the growth of employment. Early in the year there were relatively large numbers of jobless workers; it was not until March that the seasonally adjusted ratio of unemployment to labor force dropped below 6 per cent. However, the number of workers unemployed for relatively long periods of time declined steadily, as had been the case since the third quarter of 1958. By midyear, just before the steel strike, total civilian employment had reached an all-time peak of 66.0 million persons (seasonally adjusted), about 2½ million more than a year earlier. And the unemployment ratio, while still relatively high compared with past periods of prosperity, had fallen to 4.9 per cent.

The recession had been about as severe in the Second District as in the nation generally, but the upturn in the District's nonagricultural employment lagged behind the economy as a whole (see Chart 3). The situation began to improve quite early in 1959, however, and until the steel strike intervened, there were increases in nearly all industries, with the greatest gains in the durable goods area. Still, in July, when the country as a whole passed the 1957 peak, employment in the District was about 3 per cent below the pre-recession high. At the beginning of 1959, over 6 per cent of the labor force was out of work in ten of the District's twelve major labor market areas; these areas were designated

NONFARM EMPLOYMENT IN NATION AND DISTRICT. Second District employment showed a net rise during 1959, but the gain was smaller than in the rest of the nation.



Note: Computed by the Federal Reserve Bank of New York from data supplied by the Departments of Labor of New York State, New Jersey, Connecticut, and the United States. Seasonally adjusted; 1958=100.

CHART 3

by the Department of Labor as areas of "substantial labor surplus". By early July, the number of areas with "substantial" unemployment had fallen from ten to seven. In the other five major areas, unemployment at this point ranged between 3 and 6 per cent.

A STRIKE—DOMINATED SECOND HALF. In the second half of the year, public confidence in the basic strength of the economy was, in general, unimpaired, despite the adverse effects of the steel strike. As a result, there was a continued high level of demand for many types of goods and services. Indeed, in some sectors demand continued to rise with virtually no interruption.

The onset of the steel strike on July 15 had an immediate and sharp impact on output and employment in the steel industry and closely associated transportation and mining industries, but steel-consuming firms were not immediately affected because of the heavy advance stockpiling of all kinds of steel. Only after several months had passed did the effects of the prolonged strike become more severe. Particularly important were the developments in the automobile industry, where stoppages for model change-overs had delayed the bite of steel shortages.

By the end of October, a total of almost 500,000 workers had been laid off in the automobile, transportation, and other industries hit by the shutdown—about equal to the number of workers who were actually on strike. When layoffs were at their highest, about 6 per cent (seasonally adjusted) of the civilian labor force was unemployed, not counting workers on strike. This compared with just under 5 per cent in the late spring of 1959 and a recession high of 7½ per cent in the summer of 1958. Following the reopening of the steel mills in early November, employment rebounded quickly and, by the end of the year, was at a seasonally adjusted record of 66.2 million, 1.7 million more than at the end of 1958. Unemployment (seasonally adjusted) had receded to 5.2 per cent of the civilian labor force.

In this District, the greatest impact from the steel strike was in Buffalo, the District's steel center. Adverse developments among steel users were not very severe and occurred mainly in the auto industry and among its suppliers. The drop in the District's total nonfarm employment amounted to only ½ of 1 per cent, compared with more than 1 per cent in the country as a whole. With the return of the strikers to the steel mills in November, industrial output and employment in the District began again to advance.

Despite the general maintenance of confidence, the strike inevitably slowed the momentum of national growth. Investment outlays by business dropped sharply during the second half of the year as a result of the liquidation of inventories. Most of this liquidation was in iron and steel, and in automobiles and other durable goods manufactured from steel. A much smaller part was in copper which, as indicated earlier, also had been stockpiled heavily in anticipation of a strike. That strike, which started in August and cut off 80 per cent of the country's copper output, also lasted for an unusually long period and indeed remained unsettled in many areas even at the year end. Business expenditures for plant and equipment continued to grow in the July-December period, although this increase, hindered as it was by steel shortages, was smaller than anticipated and proved too small to offset more than a minor part of the disinvestment in inventories. With the steel mills reopened, however, businesses were able, in the closing months of the year, to reverse the decline in stocks and to increase slightly investment in new plant and equipment.

Most types of personal consumption expenditures, on the other hand, continued to rise during the second half of the year despite the temporary dip in income, although the pace of the rise was much slower than during the first half of the year. Spending on durables fell off somewhat in the last two months of the year, not because of any faltering in demand, but because steel shortages had slowed the output of new cars. Consumer spending in the Second District, as evidenced by department store sales, also held up well through the strike and in December was about 4 per cent higher than a year earlier.

MIXED PRICE MOVEMENTS. Broad price averages showed only a small net rise during 1959, although the apparent absence of movement in the aggregates masked significant changes for some important groups of products and services. For most items there were only slight to moderate increases over the year; strongly rising demand and some cost increases applied upward pressures, but these were limited by the prevalence of ample capacity in most lines and in certain instances by vigorous foreign competition.

Among consumer prices, as shown in Chart 4, the principal increases were in prices of services and nondurables other than food. Service costs continued a long-term rise that has reflected increasing rents and the pressures of rising labor and other costs in areas where there seems to be comparatively little room for productivity gains. In contrast, prices of consumer durables rose less than

PRICE MOVEMENTS. The decline in food prices in 1959 partly offset increases in other lines, but still there was a small net rise in over-all prices of consumer goods and services. Prices of producer durables rose by about the same small amount as in the preceding year.

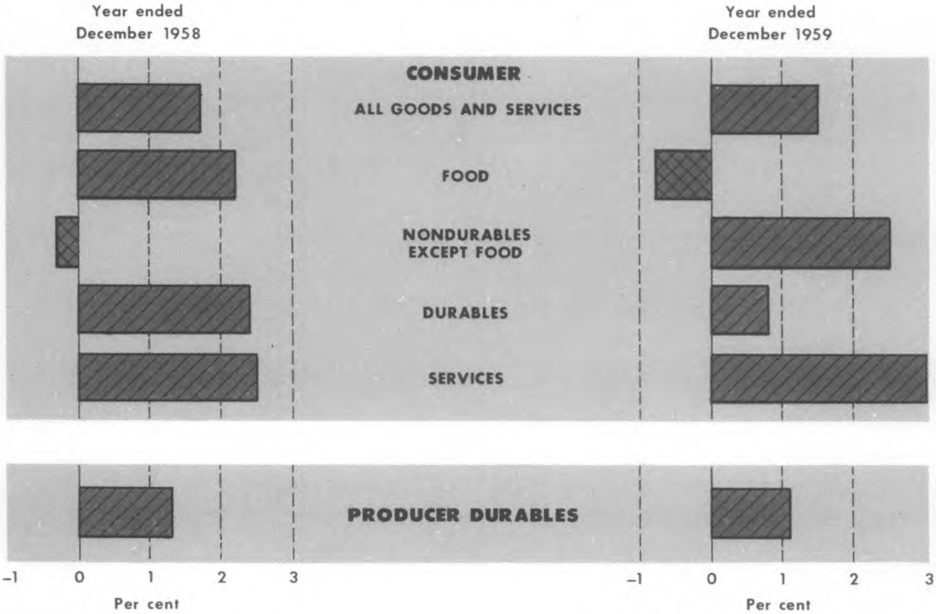


CHART 4

Source: United States Bureau of Labor Statistics.

in other recent years; new cars, in particular, were nearly unchanged in price over the year.

The outstanding exception to this general pattern was in the agricultural area. At the wholesale level, prices of farm products fell by 5 per cent over the year to the lowest point in nearly four years. Reflecting this decline, consumer food prices dipped by 1 per cent during the year. Much of the drop centered in meat prices, reflecting unusually heavy production and marketings that had been stimulated by higher prices during 1958.

The Pattern of Credit Demands

Demands for credit were unusually heavy during 1959. In particular, the huge new money needs of the Federal Government, at a period of the business cycle when the Government should, ideally, be retiring debt out of surplus, were a source of pressure upon the credit markets. Consumers also stepped up their demands for new credit. Indeed, the single largest increase in borrowing during the year was the leap in mortgage indebtedness. Corporate business in the aggregate cut back its use of outside funds in 1959, partly because retained earnings and depreciation were large and partly because the decline in inventories in the steel and related industries freed funds for other uses. (See Chart 5.) Nevertheless, the total effect of aggregate credit demands was such that credit markets came under mounting pressure during the year.

GOVERNMENTS IN THE CREDIT MARKETS. The new debt shouldered by all governments combined was about as large in 1959 as in the year before.

NET INCREASES IN CREDIT INSTRUMENTS OUTSTANDING. Strong demands for credit from governments, consumers, and businesses converged on the financial markets in 1959.

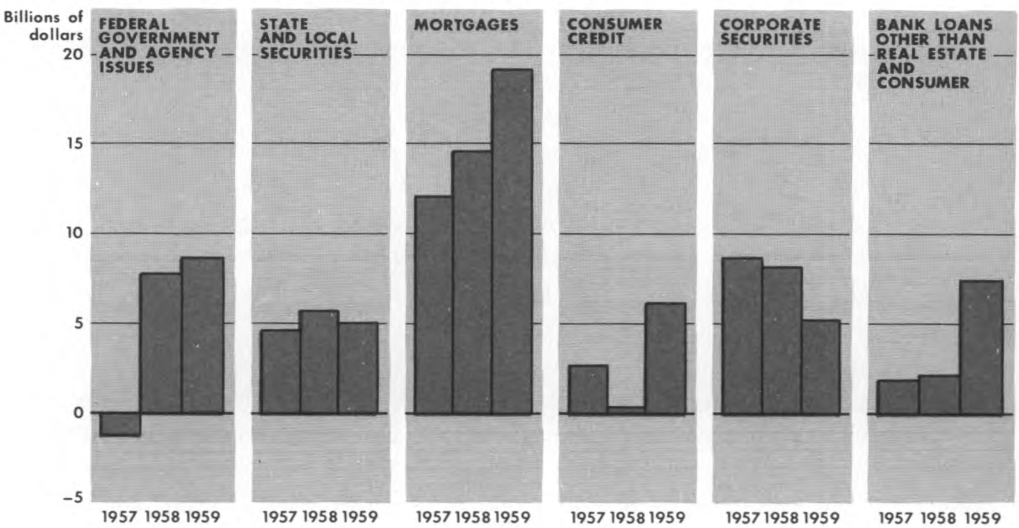


CHART 5

Source: Board of Governors of the Federal Reserve System.

The Federal debt went up more than in 1958, when the immediate impact of the recession was being felt. But State and local governments, whose expenditures have marched up with mechanical regularity for a decade and longer, were able in 1959 to finance a larger fraction of these outlays out of current income and hence increased their debt by a smaller amount than in 1958. Even so, the magnitude of government borrowing was impressive. Taking all governmental units and agencies together, total indebtedness rose by about $13.7 billion over the year, a figure slightly exceeding the previous peacetime record of $13.5 billion posted in 1958.

For the Federal Government, revenues rose appreciably but cash expenditures also advanced considerably over the year before, chiefly because of delayed effects of the recession. Moreover, Federal agencies (the various institutions providing supplemental credit facilities for housing and agriculture, in particular) floated a record volume of issues during the year, an amount nearly double their new borrowings in 1958. All told, the publicly held debt of the Federal Government and its agencies was higher by $8.7 billion at the end of the year, compared with a rise of $7.8 billion in 1958. The rise for all other units of government was $5.0 billion this past year and $5.7 billion in 1958.

Along with the difficulties of so much new borrowing, the Treasury faced a vexing problem in scheduling the maturities of both new flotations and refunding issues. As the year wore on and market rates of interest moved higher, the statutory ceiling of 4¼ per cent on new Treasury issues maturing after five years created a genuine problem for the first time since Congress established this rate in 1917. Accordingly, the Treasury in the latter half of the year found it necessary to finance exclusively with shorter maturities. The average maturity of outstanding marketable debt moved down during 1959 from four years and nine months to four years and four months, the shortest year-end average in the postwar period. And, more important for its impact on the capital markets, the volume of outstanding marketable debt maturing or callable within five years rose by $7.8 billion, of which $7.3 billion was due within one year.

THE ROLE OF BUSINESS. While businesses increased their indebtedness appreciably during 1959, the business sector was also a major supplier of credit to other segments of the economy. The combination of rising profits, relatively low tax payments (based partly on the low 1958 profits), and growing depreciation allowances generated a large volume of funds internally that could be used to finance larger inventories and higher outlays on plant and equipment. Of course, many business concerns found it necessary to turn to "outside" financing, either in the capital market or from the banks. But this financing was counterbalanced for the aggregate of all business concerns by increased tax reserves and other types of cash accrual which were invested in short-term Government securities and other liquid money market instruments. To a significant degree, the availability of corporate cash for short-term investment supplied the funds which the Treasury borrowed to finance its cash deficit. The position of corporations in 1959 as relatively large suppliers of funds to the capital markets was similar to the 1955 experience, suggesting that this pattern of business cash flows may perhaps be emerging as typical of the earlier phases of business recovery and expansion.

The net new issue of debt and equity instruments by corporate business was quite modest for a period of economic expansion, with the total actually falling well below the $8 billion of 1958, a recession year. Apart from the cutback in size, there was also a shift in financing methods. With bond yields moving higher and stock prices advancing, thus cutting the relative cost of equity financing, the net new issue of corporate bonds fell to $3.1 billion, the lowest since 1955. At the same time, new equity issues rose to about $2.1 billion, the first time since 1955 that corporations have raised so large a share of new capital through stock issues. Although tapping the capital market for relatively moderate amounts, business (corporate and other) borrowed heavily from commercial banks. The $5.3 billion rise in business loans proceeded unevenly over the year, spurting during the period of heavy inventory build-up in the spring, tapering off in the late summer and early autumn when seasonal slackness and the steel strike caused demands to subside a bit, but accelerating again toward the close of the year as business activity rebounded and liquidity positions came under more pressure.

THE HEAVY DEMANDS OF CONSUMERS. Along with business firms, individual investors also absorbed Government and other securities on a large scale during 1959, although it is difficult to be sure of the exact amount from available figures. Whatever the facts on individuals as investors, however, it is clear that they also demanded extensive new credit for themselves during the year. They seem indeed to have added substantially to the over-all pressure for new credit. For, while incomes were rising during most of the year—personal income after taxes rose from $323 billion in the fourth quarter of 1958 to $341 billion a year later (at seasonally adjusted annual rates)—expenditures on the whole rose still more rapidly.

With the rebound of the economy, the flow of new instalment credit turned sharply upward in the latter months of 1958 and rose very rapidly through most of 1959. By the end of 1959 the total of such debt outstanding was, in fact, more than $6 billion higher than at the beginning of the year, an increase nearly equal to that of 1955. An important portion of the expansion over the year was attributable to consumer borrowing for the purchase of automobiles. But of perhaps more significance was the strong upsurge in the remaining portion of instalment credit, which was much more pronounced than in 1955. While information on credit terms is unfortunately too fragmentary to establish any general trends, growth in automobile credit appears to have been encouraged to some extent by easier contract terms, particularly longer maturities. This tendency was much less important, however, than in 1955.

The growth of mortgage debt set a new record in 1959 and housing starts rose 14 per cent above 1958, despite a slower pace in the second half of the year. Total mortgage indebtedness rose by a resounding $19 billion, a figure more than a fourth again as large as in 1958 and almost 20 per cent above the old record set in 1955. Some of the funds went into apartment housing and into corporate building programs. But much the sharpest advance occurred in the financing of one- to four-family residences. A part of the tremendous surge was a delayed response to the Emergency Housing Act of 1958. This legislation had modified the terms of Federally underwritten mortgages—raising maximum interest rates and relaxing discount controls—and so helped to place a large volume of these mortgages with private investors. Under the same Housing Act, the Federal National Mortgage Association (FNMA) had received additional authority to purchase mortgages on low-cost housing. The $1 billion actually spent by FNMA during the first half of 1959 reflected to a large extent the takedown of commitments made earlier under this special legislation. In the later months of the year, there was some leveling-off in the rate at which new mortgages were recorded, but the volume continued high.

THE SUM OF THE PARTS. Taking together the behavior of these different segments of the economy—governments, businesses, consumers—it is not surprising that pressure on the capital and credit markets was heavy during the year.

On the basis of the flow-of-funds estimates constructed by the Board of Governors, net growth in credit outstanding during 1959 was more than $50 billion and exceeded the previous peacetime record year by more than one third. There were, to be sure, large amounts of new savings to be channeled where needed. Indeed, as Chart 6 indicates, the growth in holdings of capital and credit instruments was most pronounced outside the banking system—in contrast to 1958—as savers supplied funds either directly or through nonbank financial institutions.

The process of allocating the supply of loanable funds among strong competing demands undoubtedly resulted in some downward revision of borrowing plans, although it is not possible to estimate the total of such reductions. On the one hand, some would-be borrowers found that the availability of borrowed funds had become increasingly restricted, or that costs had reached a point at which they overbalanced the anticipated profitability of the credit. On the other hand, holders of cash or near-cash balances found that the rate of return available on a less liquid asset had made these balances, in effect, too costly to hang on to.

CHANGES IN HOLDINGS OF CREDIT INSTRUMENTS BY MAJOR INVESTOR GROUPS. **Credit demands were met principally by nonbank lenders as the record increase in bank loans was largely offset by bank liquidation of securities holdings.**

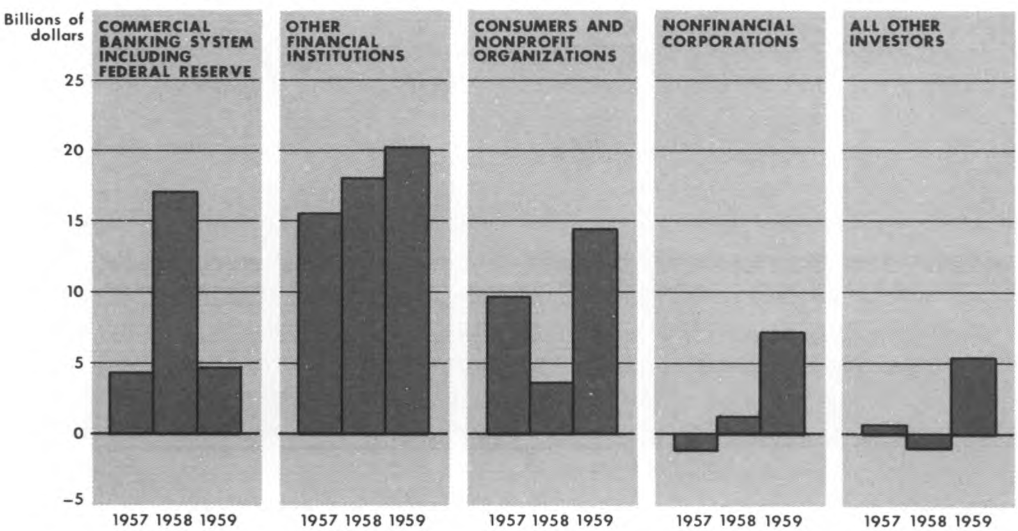


CHART 6

Source: Board of Governors of the Federal Reserve System.

MONEY SUPPLY AND DEPOSIT TURNOVER. For a year of strong business expansion the money supply (currency and demand deposits) rose only moderately in 1959, while the turnover of demand deposits pushed substantially higher.

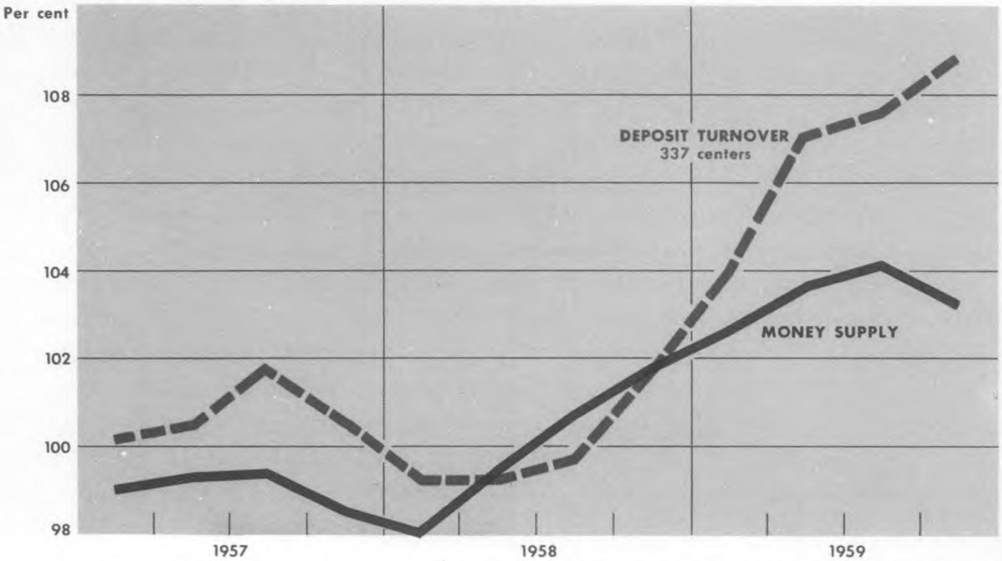


CHART 7

Note: Both deposit turnover and money supply are seasonally adjusted and are shown as quarterly averages, 1958=100.

For example, many individuals and others made this substitution by financing the purchase of Treasury 5 per cent marketable notes (the "Magic Fives" offered in October) out of withdrawals from savings accounts. Further, business concerns, State and local governments, and others were given substantial inducements to economize cash balances by the concentration of Treasury financing in the less-than-one-year maturity sector, and the associated upsurge of short-term interest rates to around 5 per cent.

In sum, the process of mobilizing funds through the financial markets to service the huge demands for capital and credit in 1959 entailed heavy drawing upon the banking system's stock of liquid assets and a moderate reduction in the liquidity of the economy at large. A further manifestation of this process was a pronounced increase in the velocity of money, as a much larger volume of business was transacted with a money supply that had grown only moderately (see Chart 7). The only way in which credit could have been supplied in such volume without these effects upon liquidity, given the savings habits of the public, would have been through permitting the commercial banking system to supply a larger share of credit requirements through further expansion in the money supply. This could have prevented the reduction of liquidity, but only by courting inflation.

Credit Policy: From Neutrality to Restraint

Credit policy in 1959 shifted from neutrality to restraint. Confronted with large and growing demands for credit, Federal Reserve policies were designed to place firm limits on the liquidity of both the banks and the nonbank public.

The central problem for credit policy in 1959 arose from two related facts. First, while the economy had recovered to the pre-recession level of output by the beginning of the year, the productivity gains meant that fewer people were employed in turning out the same, or even greater, total product. Moreover, the labor force continued to grow. Thus, wholly apart from the usual desire for further growth, there was a vital need to reduce unemployment through further expansion of economic activity—which the Federal Reserve wished to encourage. But, second, with a strong expansion already under way, the monetary authorities had to be alert for any outburst of demand for credit that would suddenly swell total spending beyond immediate capacity, either in general or in major sectors of the economy. In short, expansion always carries with it the potentialities of a credit boom, with attendant pressures on prices, which may, if not carefully watched, break out into a "demand-pull" inflation. To be ready for such an eventuality, the banking system had to be brought into such a position that credit could not balloon out of control, even for short periods.

This broad sketch of the problem fails, of course, to depict in full color and dimension the dramatic events that occurred within the year—in particular, the interruption to expansion that resulted from the steel strike. Not only did the steel strike stop production in a key industry, but it also befogged most of the current economic indicators throughout the year. Even before the strike, precautionary stockpiling of steel was a strong influence in the rapid expansion of output. And after the strike began—indeed, through the end of the year—steel shortages acted as a check on business investment, on consumer spending, and on production. In addition to these conspicuous developments on the domestic scene, the adverse United States balance of payments was another factor to be taken into account in shaping credit policy.

CREDIT POLICY BEFORE THE STEEL STRIKE. As the year opened, the economy had pretty well passed through recovery and seemed well on its way to a new boom. But the picture was not entirely clear. The level of employment was moving up only slowly toward pre-recession levels, and unemployment was still sizable. This uncertainty of pace in the employment data also seemed to be reflected in commercial bank credit. Total bank loans went into their usual January-February slump, and at the same time commercial banks began to reduce their securities holdings (see Chart 8). Total loans and investments thus fell more than they typically do in these early months. In spite of the slack demand for bank credit, the capital markets remained under rather considerable pressure, and interest rates in the middle- and long-term maturities inched

BANK CREDIT AND LIQUIDITY. In 1959 banks cut back investments — mainly in Treasury issues — to make room for loans. This limited the rise in bank credit and pushed up the loan-deposit ratio to the highest point in many years — a rough indication of the banking system's curtailed liquidity.

CHART 8

Note: Loan-deposit ratio is the ratio of loans (adjusted) to total deposits less cash items in process of collection.

MEMBER BANK RESERVE POSITIONS. By the spring of 1959, bank reserves had come under considerable pressure, necessitating substantial borrowing at the discount window.

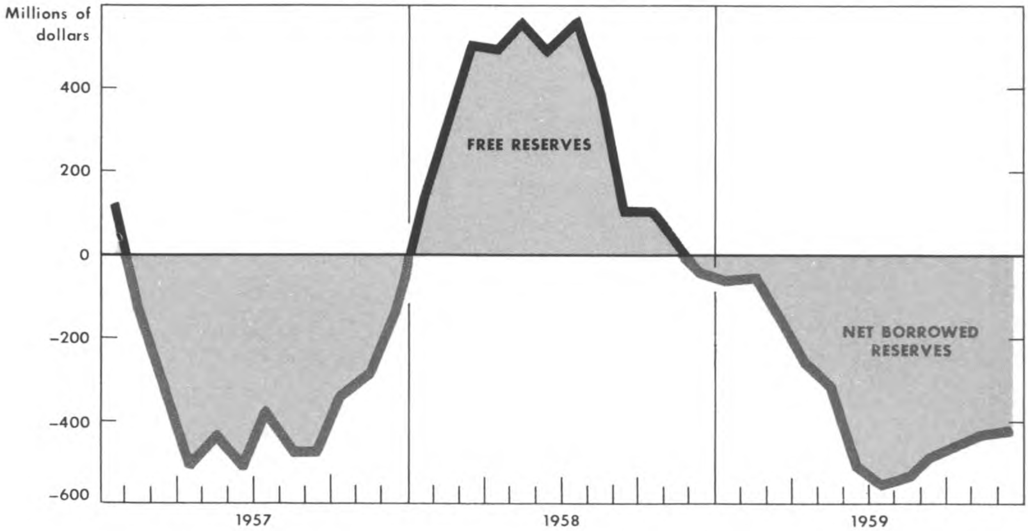


CHART 9

Note: Monthly averages of daily figures.

upward through most of January, before backing down again somewhat in February. The Treasury found it necessary to borrow large amounts of money, and borrowing by State and local governments also grew to substantial proportions. The frequency with which the Treasury, in particular, had to return to the market for funds was a potent influence on credit markets.

In view of the continuing high rate of unemployment in these early months of the year, and the more-than-seasonal decline in bank credit, greater reserve pressures on commercial banks did not seem to be called for. The seasonal flow of reserves into the banking system that is normal early in the year was sopped up, as usual, through the System's open market operations, but no new action to restrict credit was undertaken. Commercial banks became less liquid, as their holdings of short-term liquid assets declined, but the over-all availability of member bank reserves remained relatively constant. As one rough measure of this, banks' net reserve positions fluctuated narrowly in the neighborhood of zero throughout January and most of February, approximately unchanged from the last two months of 1958 (see Chart 9).

By late February and early March it began to be evident that businesses were laying in inventories at an accelerated pace and recalling their workforces more rapidly than earlier. And, as the spring months passed, the economic data increasingly confirmed this sense of quickened activity. By the end of June, the economy seemed clearly at the threshold of a full-scale boom, if not already into one. The renewed vigor of business activity had a pronounced effect on bank credit. Loans bounded up sharply in March, and in April and May they expanded at rates not seen at this season for a decade or more. The advance in June, while not quite so spectacular, was also pronounced.

Treasury borrowing continued in relatively large volume during this period, and a heavy volume of municipal offerings continued to flow into the capital markets. In addition, corporate flotations rose somewhat from the relatively low level recorded early in the year. All these demands combined to push market rates of interest even higher (see Chart 10). And on May 18, major commercial banks around the country raised the "prime" rate—the interest rate charged to borrowers of the highest credit standing—from 4 per cent to 4½ per cent. Stock market prices advanced rapidly, probably reflecting both the broadening business upswing and a spreading concern over new inflationary pressures.

The accelerating pace of economic activity and the accompanying burst of demand for credit of all types necessitated more aggressive efforts by the Federal Reserve System to keep a checkrein on the growth of bank credit and to head off inflationary credit expansion. Reserve funds were not supplied to support the large volume of new loans banks put on their books, and banks' liquidity was subjected to a progressive squeeze as they found it necessary to sell money market securities to raise funds for their new loans. As a result, the increase in total bank credit and in the money supply was moderate. Not all of the sharp spurt in bank loans was financed, however, by divestment of securities. Banks as a whole also obtained funds by reducing excess reserves and by increasing the outstanding total of their changing individual borrowings from Federal Reserve Banks. The upshot was that net borrowed reserves of member banks moved up almost continuously from late February, rising to about $550 million in June. In addition, discount rates at the Federal Reserve Banks were raised twice during the four-month period—from 2½ to 3 per cent in early March and to 3½ per cent in late May and early June. These moves followed increases in market rates of interest, but System policy was partly responsible for the higher market rates, so that increases in discount rates were part of a program of establishing firmer restraint.

INTEREST RATES AND STOCK YIELDS. Sustained demands for funds and limits on bank credit growth pushed interest rates to postwar highs in 1959. Shorter term rates registered the greatest rise, partly because the Treasury was obliged to concentrate its borrowing in this area.

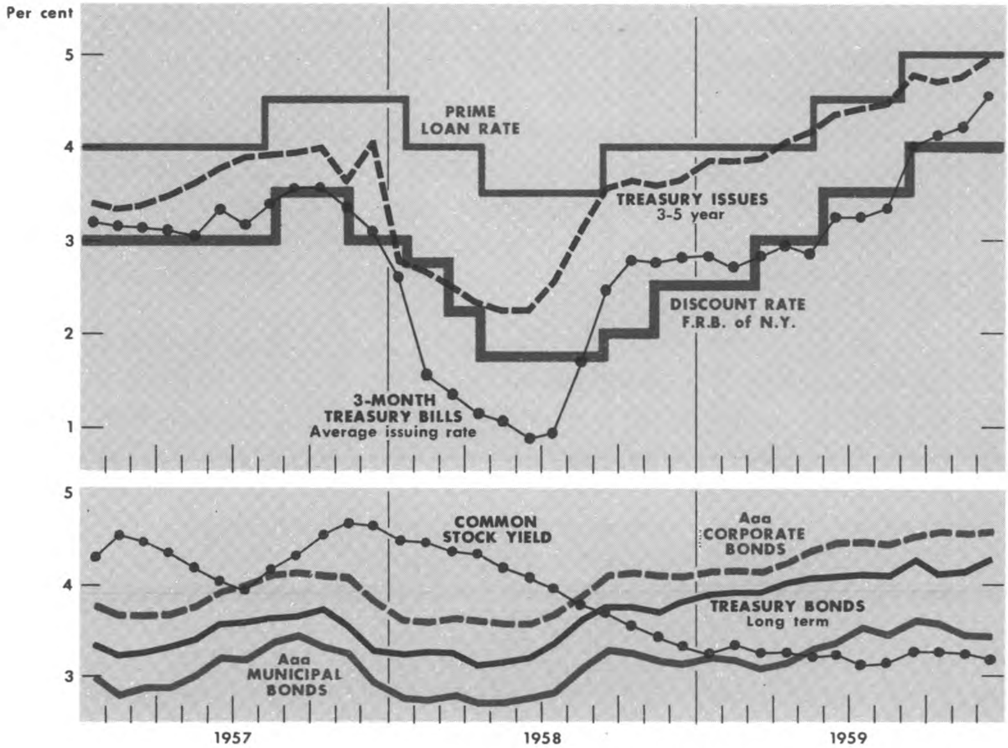


CHART 10

Sources: Board of Governors of the Federal Reserve System, Moody's Investors Service, and Standard and Poor's Corporation.

STEADY PRESSURE IN THE SECOND HALF OF 1959. The steel strike lasted from mid-July to early November, but not until about halfway through this period did the drag on economic activity begin to be evident in total bank lending. Business borrowing at banks tended to be less buoyant after July, as the steel strike wore on and inventories were gradually depleted. Consumer and real estate loans, on the other hand, continued to rise very steeply until late in the year.

The volume of new corporate securities flotations was much reduced during the summer and early fall months, but there was still no letup in borrowing by governmental units. The third quarter is typically a time of heavy borrowing by the Federal Government, and in 1959 the month of October also found the Treasury in the market. New borrowing by the Treasury in these four months amounted to $10.9 billion, and issues that had to be refinanced totaled an additional $13.9 billion.

For a time, interest rates held steady in the face of these demands upon the market. But by late August they were heading up again. The prime lending rate at major commercial banks was again advanced by ½ percentage point on September 1, bringing it to 5 per cent. And, by the middle of September, market rates of interest on obligations of almost all types had climbed to the highest levels in nearly three decades. Rates of interest generally drifted lower for a time after mid-September, as an enlarged flow of new funds into the market provided a breathing spell. Also, the market may have begun to reflect some concern that the steel strike, by running on and on, might have lessened the upward thrust in the economy. The impressive success of the Treasury's "Magic Fives" in attracting vast numbers of new investors into the Government securities market was also an important influence at this time.

Throughout the steel strike, but particularly as it stretched from weeks into months, the Federal Reserve authorities were alert to the possibility that the shutdown might dampen the economy for a considerable period after the return of workers to their jobs. It was important for the Federal Reserve during these months to be prepared to move either way. In the meantime, with most economic data continuing to signal underlying economic strength, the indicated policy for the monetary authorities was to keep the banking system under about the same pressure that had prevailed when the steel mills first shut down. Reserves were supplied through open market operations in each month of the four, principally to take care of seasonal requirements. In adjustment to the renewed upward movement of short-term interest rates in late August and early September, the twelve Federal Reserve Banks raised their discount rates from 3½ to 4 per cent in the first half of September.

Once work was resumed in the steel industry, the economy began quickly to move back to a high plane of performance. Business borrowing from commercial banks increased only seasonally in November but rose much more rapidly in December—by an amount second only to the huge 1958 increase for that month. In the capital markets, the movement of yields was somewhat irregular but on the whole tended upward. By the year end, in fact, interest rates on debt instruments of most types were at record levels since the early 1930's.

The Federal Reserve System provided a part of the seasonal need for additional bank reserves in the closing weeks of 1959 by allowing member banks to count part of their vault cash toward meeting reserve requirements. Acting under legislative authority granted by Congress earlier in the year, the Board of Governors permitted central reserve city and reserve city banks to count all vault cash in excess of 2 per cent of their net demand deposits for this purpose, while for country banks the amounts over 4 per cent could be counted. Other minor changes in the method of computing required reserves also had the effect of supplying member banks with additional reserves.

The year-end period normally brings with it a large-scale shuttling of funds about the country, with a consequent loss of available funds from the central money market. The underlying liquidity position of New York banks came under particularly strong pressure toward the end of 1959. In the latter part of the year they had expanded their loans much more rapidly than banks elsewhere, while their time deposits declined steeply. Reflecting the pressures generated by these contrasting movements, the New York banks liquidated their securities holdings several times as fast as other banks.

In the face of divergence between statistical indications of somewhat reduced pressures on reserves and the fact of continued tightness in the money markets, the System sought, through its open market operations, to keep the tone of these markets from changing significantly in either direction. As the year came to a close, the especially hectic period had passed, although the uncertainty hanging over the economy had not been dispelled. The threat of a renewed steel shutdown was not removed until after the end of the year, and even then uncertainties over the effect of the strike on the future pace of economic activity and over the effect of the settlement terms on prices were important influences on the outlook.

THE YEAR AS A WHOLE. Over 1959 as a whole, credit policy thus moved from neutrality to outright restraint in the first half of the year and then maintained restraint during the uncertain, strike-dominated second half. Nonetheless, lending by commercial banks over the year supplied a record $12 billion to businesses and consumers, thus providing the wherewithal for a real expansion in economic activity.

At the same time, the very small increase in total reserves supplied to the banking system—amounting over the year to only about $30 million—and the fact that member banks had to seek reserves through the "discount window" forced banks to finance the loan expansion primarily by disposing of Government securities. Total bank credit—that is, loans and investments taken together—in fact showed the smallest rise in ten years. This near stability of total bank credit held down the increase in the publicly held money supply (i.e., demand deposits adjusted and currency outside banks) to less than 1 per cent.

To look at 1959 by itself, however, is to take too narrow a view. For when 1958 and 1959 are considered together, the total increases in bank credit and money supply were quite large—$18.5 billion and $6.9 billion, respectively. Thus, the liquidity created by the banking system during the recession and recovery months of 1958 was in large measure available in 1959 to meet the special needs of an expanding economy. Moreover, the nonbank public acquired a large volume of Treasury securities in 1959 and thus increased substantially its holdings of highly liquid assets. Despite the increasing intensity with which money was used and the higher level of debt incurred, the nonbank public was probably only slightly less liquid at the end of 1959 than it had been a year earlier.

The liquidity position of commercial banks also takes on new dimensions when the two years are considered together. To be sure, the ratio of loans to deposits at all commercial banks had risen to 54 per cent at the end of 1959, the highest year-end level since the 1920's. But it is important to realize that the $8.1 billion reduction in bank holdings of Governments during 1959—the means by which much of the loan expansion was financed—was almost exactly equaled by the large increase in such holdings in the previous year. Banks might be said to have drawn heavily during 1959 on the high degree of liquidity that they possessed when the year began.

The events of 1959 did, however, bring the liquidity positions of banks under increased pressure and, by the year end, these were becoming a more active influence on bank portfolio practices. As a result, the System's ability to control further advances in bank lending was increased substantially in 1959.

THE END OF THE FIFTIES

When the 1950's began, the economy was just beginning to make its way out of the first postwar recession. Although the gloomier of the appraisals of postwar business prospects had already proved unduly pessimistic, there still was fairly widespread apprehension as to whether the business community would muster the confidence and vitality needed to maintain full employment. As we now know, business investment in capital goods and research reached unprecedented and at times inflationary rates during the fifties, and played a central role in making the decade a period of unequaled prosperity.

Dramatic growth in technology and in productive capacity occurred despite the intrusion of another unanticipated, and unwelcome, factor: resumption of the arms race. An extrapolation of the early postwar developments might have suggested that the 1950's would be years of reduced military outlays and lower tax burdens. Defense spending in the fiscal year ended in June 1950 was $13 billion, in a total budget of not quite $40 billion, while GNP was running at about $265 billion (all in the then-current dollars). Even when the Korean struggle began, it was widely expected that the increase in military expenditures would last only for the duration of active combat. In fact, of course, the intensity of the subsequent "cold war" permitted relatively little retrenchment in defense spending, or tax relief. The fact that the proportion of national output devoted to *private* fixed investment during the 1950's was almost equal to that maintained in the early postwar years of retooling and expansion was a truly remarkable achievement. Investment by various public bodies, in such forms as school and highway construction, also expanded enormously, as could have been expected after years of wartime restriction and in response to the huge growth and movement of population.

Despite these massive withdrawals of resources for purposes other than the satisfaction of current consumer wants, these years also brought a prodigious and widely diffused improvement in material welfare (see Chart 11). It is easy to forget, in 1960, that ten years earlier the housing shortage was still acute (now the proportion of "doubled-up" families is at an unprecedented low); that only about one in every ten homes had a television set (now nine in ten have one); or that there were only about 35 million passenger cars on the road (compared

GROWTH IN THE 1950'S. Total real output grew substantially over the decade, with only brief and mild interruptions, though some major components of demand underwent sizable fluctuations.

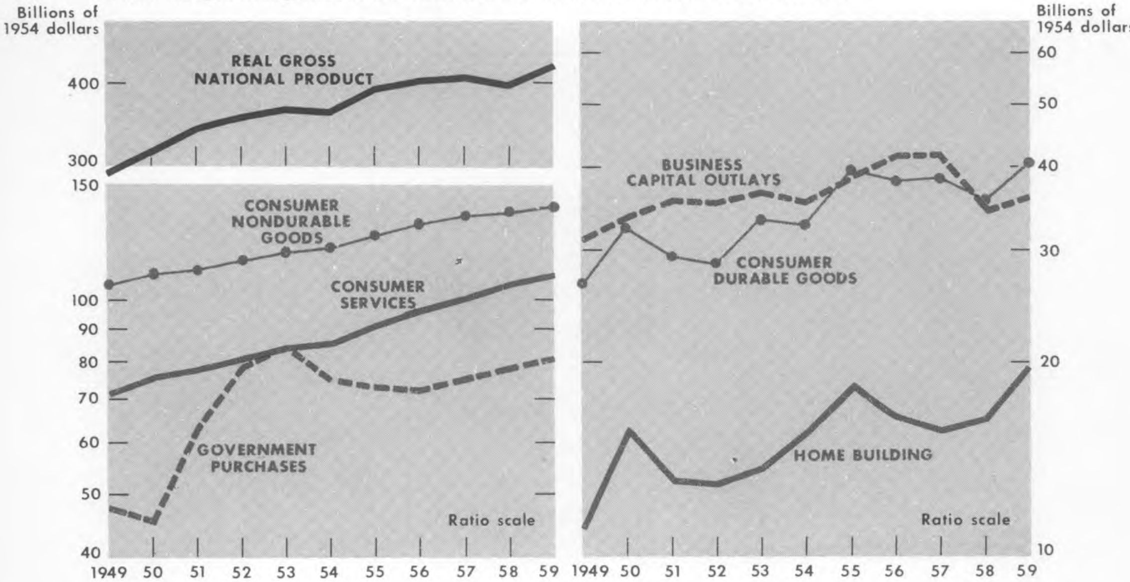


CHART 11

Source: United States Department of Commerce.

with close to 60 million currently). Nor have improvements in the standard of living been confined to readily measurable tangible goods. Such developments as the advances in medical care, broadened travel, and a wide range of cultural, recreational, and educational pursuits which have emerged from the search for fruitful employment of increased leisure time have also added to personal well-being.

These are only some among the major accomplishments of the 1950's that observers standing at the threshold of the decade might have hesitated to predict. And even more difficult to anticipate would have been the timing of particular developments. Demand pressures emerged first in one sector and then in another. One after the other, major shifts of labor and adaptations of production patterns had to be made—and largely were made. Indeed, the relative smoothness with which these repeated adjustments were accomplished was itself an impressive achievement.

Certainly, the most obvious shifts in demand, and resulting shifts in resources, arose from changing military needs. The Korean conflict of course compelled an enormous step-up in military drafts on the economy, both for manpower in the armed forces and for war materials. And, while the end of the open conflict permitted a release of military manpower, the levies on the country's industrial capacity and civilian labor force largely continued. But these, too, were continually changing in amount and character. Jet aircraft replaced piston aircraft, and now missiles are crowding out manned aircraft. Dramatic events such as Soviet nuclear-weapons developments, and the sputniks and their successors, all had their impact on military needs.

The volume of business capital formation also was in continuous flux. Such investment was already on the advance in the first part of 1950 and was further stimulated by the sharp increase in both military and civilian demand associated with Korea. In the mild recession of 1953-54 that followed the partial unwinding of the war economy after the Korean truce, most industries curtailed capital outlays in the usual cyclical pattern, but an accelerated expansion in various types of commercial building (including prominently the modern "shopping center") held the over-all decline in business fixed investment to modest proportions. There followed, in 1955 and 1956, a burst of fresh investment in new plant and equipment extending to virtually all major industries. This surge gave way in late 1957 and 1958 to a sharp and quite general cyclical setback, to be succeeded in turn by renewed capital expansion in 1959 as described earlier in this *Report*. And as business capital investment and the accompanying drafts on the capital markets waxed and waned, mortgage money became alternately tighter and easier, contributing to an inverse pattern of cyclical fluctuation in home-building activity.

But throughout the decade, regardless of the phase of the business cycle, business expenditures on research were being maintained or increased. Government-sponsored research in electronics and other fields initiated for military purposes also contributed many results with nonmilitary applications. Productivity of capital goods and labor continued to progress. Though the rate of productivity advance varied widely over the period, the aggregate gains were large and go far to explain the production feats of the decade. As 1959 closed, for example, the output of the manufacturing, mining, and utility industries was some two-thirds greater than ten years earlier with only about 10 per cent more employees.

The consumer, too, proved variable in many of his demands, as the growth of income and of credit facilities expanded opportunities to purchase—and to decline to purchase—many more goods and services, including what formerly were luxuries reserved for a few. Korea touched off a buying spree in fear of shortages; when these did not materialize to the extent feared, buying tempers sobered. Rising incomes, easy credit terms, and attractive products and prices, the latter reflecting primarily the spread of discounting and discount houses, produced another surge of consumer demand in 1954-55. But consumer preferences were far from stable; thus, sales of conventional American automobiles boomed to over 7 million in 1955 but fell back to only about 4 million in 1958, while sales of smaller foreign and American cars jumped sharply. In 1959, the industry responded to the changing preferences of the public by introducing several models of smaller and more economical cars. In contrast to "discretionary" or "deferable" purchases, however, demand for staple items such as food displayed a nearly steady growth, even in the face of recessions, and the expansion of outlays on "services" seemed to be virtually unaffected by cyclical swings.

The economy of the 1950's was thus one of high and quite persistent pressure on the nation's economic resources. The equivalent of less than two full years of the ten were years of business recession. At most times the economy was challenged by a pace of demand that was close to its capacity to produce, and that also required a continuous adaptation of production to meet the changing demand mix. One symptom of the strains that inevitably ensued was a marked rise in prices and costs over the period. Indeed, at times there was a spreading expectation that the rise could continue indefinitely in a "creeping inflation".

Sustained pressure was evident in the financial as well as the industrial structure. The high rate of investment—by consumers, businesses, and government units alike—necessarily entailed a rapid expansion of debt. And since the monetary authorities were obliged during most of the period to lean against the prevailing inflationary winds by limiting the growth of credit, there was also a need for economizing on cash assets. For the banking system this meant that, during periods of intensive loan demands, these demands could be met only through liquidating Government securities—if they were met at all. Commercial bank loans increased by $67 billion over the decade, but their total investments barely changed on balance, and their holdings of Government securities shrank by some $9 billion. One consequence of this massive shift seems to have been that the banks have had to place greater reliance, for liquidity needs, upon the shiftability and maturity of earning assets, and on automatic amortization features of loans, and less on merely tapping their now-depleted reservoir of Treasury securities.

A corollary of restraint on bank credit growth was that the nation's money supply (currency and demand deposits) increased by a modest 30 per cent during the period, compared with the near doubling of GNP. But growth of a variety of near-money assets proceeded swiftly. Shares in savings and loan associations grew by a spectacular 333 per cent, time and savings deposits in commercial banks and mutual savings banks grew by 80 per cent, and short-term Treasury securities owned by the nonbank public were up by 170 per cent. In dollar amounts, these near-money assets alone added more than $100 billion to nonbank holdings of liquid assets.

Heavy credit demands and the limitations upon money supply growth led to a substantial rise in interest rates over the period. Ten years ago, when Treasury bond yields were below 2½ per cent and Treasury notes yielded less than 1½ per cent, few citizens would have ventured to predict that in 1959 the Government would have to offer 5 per cent on a five-year note and would be unable to market longer maturities because of the 4¼ per cent interest ceiling. No doubt, moves of this size in market interest rates caused some dislocations—but there is little doubt also that even greater dislocations would have resulted from an effort to hold rates at an artificially low level when credit demands were rising.

The world being what it is, the 1960's may well bring as many or more challenges, crises, and surprises as the 1950's. Inventiveness, the willingness to take risks, and the whole range of social attitudes embodied in the concept of "mobility of resources"—qualities which the American economy demonstrated in abundance during the 1950's—will be no less vital. At the same time, the need to make difficult choices and sometimes to accept personal sacrifices will be no less pressing.

THE UNITED STATES AND THE WORLD ECONOMY

In 1959 the United States found itself in a strikingly transformed world economy, as various changes in international economic conditions and policies that had been developing for some time appeared to crystallize. Foreign industrial countries left behind them the postwar era of United States-assisted recovery, of "dollar shortage", and of stringent restrictions against dollar-area products, and moved forward under their own power into a period of dynamic growth. The world trade and payments system revealed itself as stronger than many had suspected—and indeed stronger than in decades. Largely because of these changes new problems emerged, and old problems, partially submerged in earlier postwar years, came into sharper focus. Most dramatic was the persistence for a second year of a large deficit in the United States balance of payments, which remained a matter of concern despite signs of improvement in the second half of the year. At the same time, the need of underdeveloped countries for well-balanced and rapid economic growth received intense attention and was exposed as the prime problem facing the West. At the onset of the 1960's, the Free World was in a stronger position than ever before to meet the economic issues confronting it.

Deficit in the United States Balance of Payments

PAYMENTS DEFICIT AT AN ALL-TIME HIGH IN 1959. The United States incurred a record payments deficit with the rest of the world in 1959. Receipts from abroad had exceeded outpayments in 1957, largely because of the abnormal demands for our exports stemming both from the Suez crisis and from the inflationary boom abroad, but before the end of that year the balance had turned around, and in 1958 a $3.4 billion deficit was registered. In 1959, the deficit grew to a record \$3.7 billion (excluding payments to the International Monetary Fund of \$344 million in gold and \$1,031 million in noninterest-bearing notes to cover this country's increased quota).

The change in our payments position reflected, in part, differences in the timing of business recovery here and abroad. While the recovery from the 1957-58 recession was definitely under way in the United States by mid-1958, the upturn abroad began later in the year and became general only in 1959 (see Chart 12). With expansion in the United States ahead of the rest of the world, it was natural that demands for foreign goods in this country should outpace foreign demands for United States products. At the same time, however, the earlier and generally more rapid rise in interest rates here than abroad—also associated with the differing cyclical patterns—helped to mitigate the pressure on the United States balance of payments from trade accounts by reducing the net outflow of private capital. As the upswing abroad became more pronounced during the course of the year, United States exports began to pick up and the rise in our imports leveled off. Along with some special loan repayments,

INDUSTRIAL PRODUCTION. The recent expansion abroad has been strong, but it started later than the upswing in the United States.

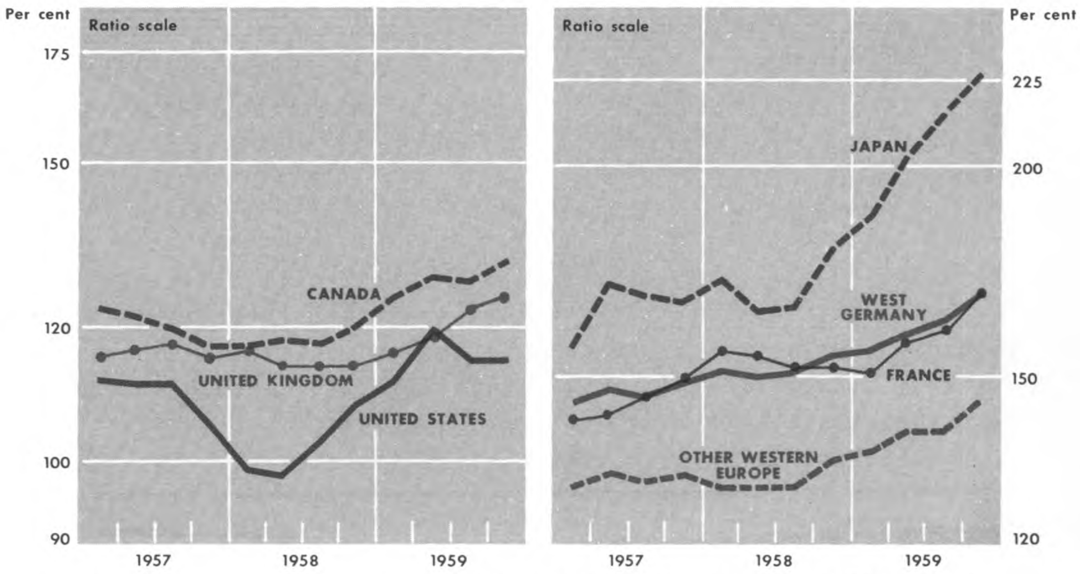


CHART 12

Note: Seasonally adjusted; 1953=100; fourth quarter 1959 partly estimated.

the improved trade balance helped reduce our over-all payments deficit in the second half of the year.

One of the most dynamic elements in our international transactions in 1959 was the enlarged demand for foreign goods. Spurred by a combination of factors, United States merchandise imports jumped by 19 per cent over 1958. Record domestic income and production led to increased demand for imports of all kinds. Greater foreign penetration of some United States markets was reflected in expanded sales here of a number of foreign manufactured products, notably automobiles and textiles. Finally, the prolonged strike in the steel industry stimulated demand for iron and steel imports. The industrial countries abroad, particularly in Western Europe, were the main beneficiaries of our import rise and thereby received a major stimulus for their own business upswing.

The business recovery abroad affected United States exports only with a considerable delay, and, as a result, merchandise exports for the year as a whole barely matched the 1958 level. The first signs of a general revival in exports came at midyear, reflecting further increases in purchases by Canada and the stepping-up of imports by Western Europe and Japan. In the fourth quarter, total exports were running (on a seasonally adjusted basis) some 10 per cent above the low reached in the first quarter of 1959. At the end of 1959 there was evidence that United States exports were well along the recovery path, but the extent of further export expansion could not be predicted with any certainty.

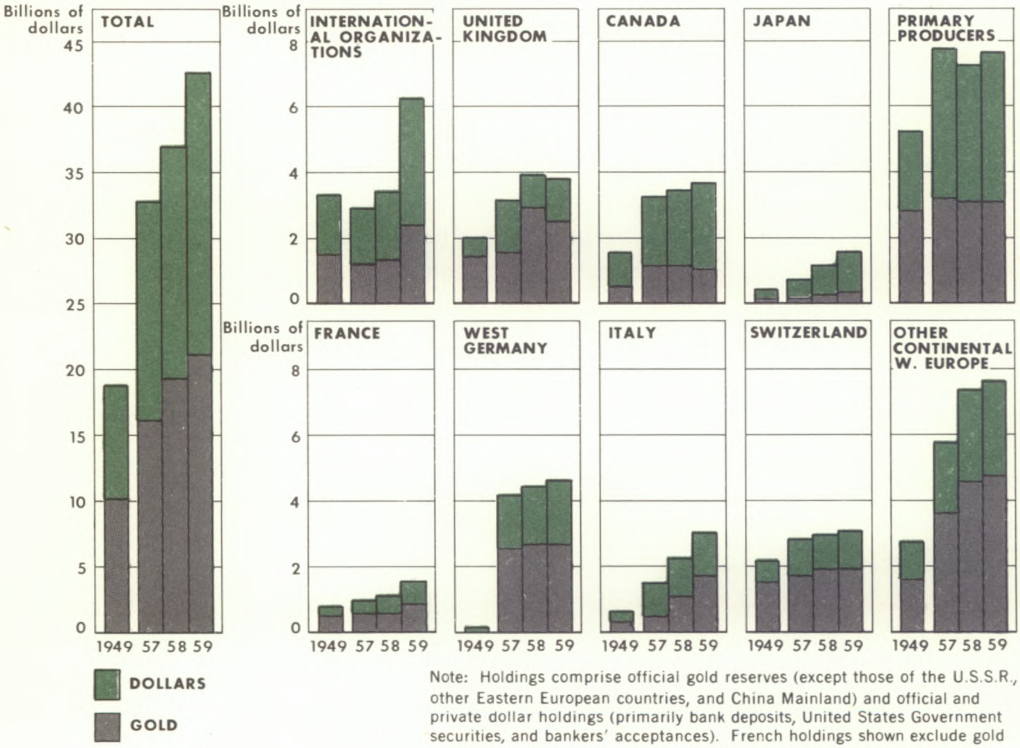
The delayed recovery of United States exports, together with the sharp rise in United States imports, cut back the merchandise trade surplus for 1959 by $2.5 billion to a postwar low of $0.9 billion. At the same time, other major elements of our international accounts—investment income and other service transactions, military expenditures abroad, private remittances, and Government grants—showed little or no change. Only a sharp drop in the net capital outflow prevented a major worsening in our over-all international payments position.

Movements in all three principal capital accounts—United States Government capital, United States private capital, and long-term foreign capital—tended to offset the deterioration in the trade balance. The net outflow of United States Government capital was reduced by more than half to $0.4 billion in 1959. The drop was mainly attributable to sizable advance debt repayments by West Germany and the United Kingdom rather than to any significant curtailment in the outflow of new funds. The faster rise in United States interest rates, compared with those in foreign markets, helped to reduce the outflow of United States private capital despite a pickup in direct investments. Flotations of foreign bonds in the United States fell back by about $0.4 billion, and the outflow of short-term capital, including loans by United States commercial banks, was reversed. The inflow of long-term foreign capital reached an estimated $0.5 billion, as against an insignificant amount in 1958, reflecting both the relaxation of capital movement controls abroad and the increase in interest rates here.

Higher domestic interest rates were also a factor, although not the most important one, behind a major change in the means of settling the United States payments deficit. In 1959, less than one fifth of the dollar gains of foreign countries and international institutions was used to purchase gold from the United States, as against two thirds in 1958. Taking account also of the $344 million gold transfer to the IMF to meet the increase in the United States gold subscription, the United States gold stock fell by $1.1 billion in 1959 as against $2.3 billion in 1958. The United States gold loss would have been reduced even more but for the increase in foreign countries' demand for gold—in part satisfied through purchases from the United States—to meet obligations to the IMF stemming from the Fund quota increases, as well as to repay Fund borrowings. Aside from $300 million of gold that the IMF sold to the United States in order to buttress the Fund's income by enlarging its income-earning assets, the easing of the gold drain in 1959 appears to have been due principally to two developments. First, most of the Western European countries that traditionally hold the bulk of their official international reserves in gold gained substantially smaller amounts of reserves in 1959 than in 1958, or actually lost reserves as against gains in 1958. Secondly, private foreign holdings of liquid dollar assets were built up at an unprecedented rate (by $1.1 billion in short-term assets plus an undetermined amount in United States Government bonds and notes), as exchange controls were further relaxed abroad and foreigners were attracted by investment opportunities here.

While the United States continued to supply dollars to the rest of the world at a very high rate in 1959, the pattern of gold and dollar flows and gains outside the United States changed sharply. All told, foreign countries and international institutions added some $5.7 billion to their gold and dollar holdings in 1959—$3.7 billion from the United States cash deficit, $1.4 billion from the increase in the United States subscription to the IMF, and about $0.6 billion in gold from new production, Russian sales, and other lesser sources. Of this, some $2.8 billion went to increase the gold and dollar holdings of international organizations (mainly reflecting the rise in IMF quotas as well as foreign repayments of borrowings from the Fund), as against only $0.5 billion in 1958. The increase

FOREIGN GOLD AND DOLLAR HOLDINGS. Western Europe has been the principal beneficiary of the build-up in foreign gold and dollar holdings since 1949, but in 1959 Europe's gains were only one half of those in 1958.



Note: Holdings comprise official gold reserves (except those of the U.S.S.R., other Eastern European countries, and China Mainland) and official and private dollar holdings (primarily bank deposits, United States Government securities, and bankers' acceptances). French holdings shown exclude gold holdings of the French Exchange Stabilization Fund. Other Continental Western Europe includes Bank for International Settlements.

CHART 13

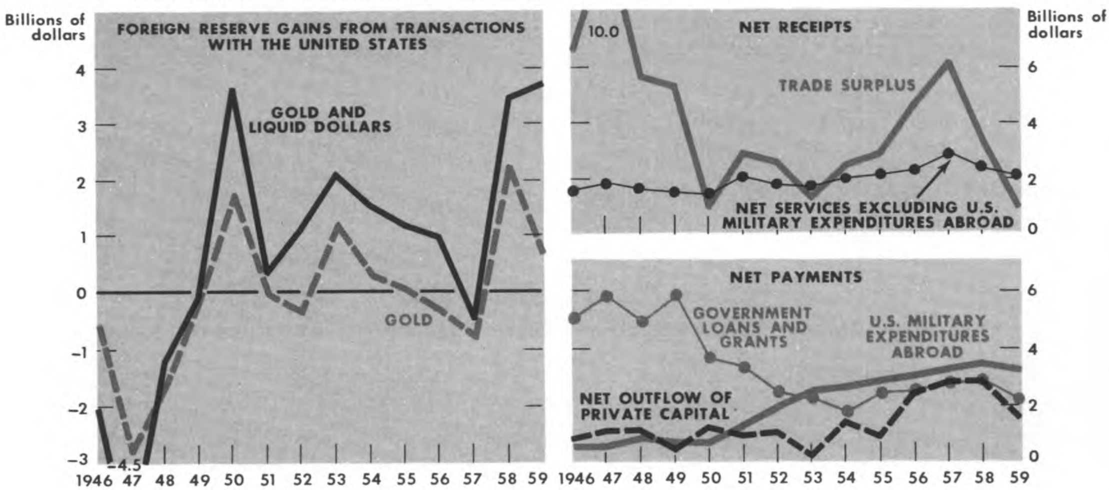
in Western Europe's holdings was cut back to about $1.8 billion from $3.6 billion in 1958, reflecting smaller gains from the primary-producing countries as well as the large transfers to the IMF. At the same time, the previous decline in the primary-producing countries' international currency reserves was reversed (see Chart 13) as their exports rose, partly in response to the economic recovery in the industrial countries.

A LONGER VIEW. The 1958 and 1959 deficits in the United States balance of payments have attracted a great deal of attention because of their size and the relative importance of the gold movement involved in their settlement. But the United

States has been running deficits—and thus adding to the international liquidity of the rest of the world—in every year since 1949 except 1957 (see Chart 14). During the ten years 1950-59, foreign countries added almost $21 billion to their gold and liquid dollar holdings, while international institutions gained $3 billion; of the total, about $18½ billion came from the United States—some $13½ billion in dollars and roughly $5 billion in gold. In the last two years, however, the United States deficit has averaged more than double the average of the seven previous deficit years—$3.5 billion as against $1.5 billion.

Since the interactions among the various components of the balance of payments are extremely complex, it is difficult to link the deterioration in our over-all balance directly to specific payments items. Some of the longer term forces at work can nevertheless be discerned—veiled though they are by cyclical and special factors that dominate year-to-year changes (see Chart 14). Notwithstanding an uptrend in the outflow of private capital and the jump in military expenditures abroad, counterbalanced by growing investment income and by a

UNITED STATES BALANCE OF PAYMENTS. Fluctuations in foreign reserve gains from the United States have mainly paralleled swings in our trade surplus. Increases in both military expenditures abroad and private capital outflows have been offset by enlarged service receipts and reduced Government grants and loans.



Note: Includes transactions with international institutions, except for initial United States subscriptions to the International Monetary Fund and the International Bank for Reconstruction and Development in 1946-47 and the additional subscription to the International Monetary Fund in 1959.
Source: United States Department of Commerce; fourth quarter of 1959 estimated.

CHART 14

drop in Government loans and grants, probably the most fundamental changes have been those in our merchandise trade. Cyclically, an apparently increased sensitivity of our exports to business conditions abroad, together with a greater steadiness of our imports, seems to have made our trade position more vulnerable during world-wide recessions.

More important, however, is the question of the competitive position of United States products. Responsible observers have expressed views that range from extreme alarm to rather surprising complacency. Clearly, the proper assessment lies somewhere between these extremes. It is only natural that our goods should now encounter greater foreign competition than in the first postwar years. The relative position of the other major exporting countries had to improve if the goals of postwar recovery were to be met. The inevitable narrowing of the technological gap between United States and foreign producers has ended the unique position of many American products, but it has not in most cases rendered them uncompetitive. There are, of course, conspicuous areas of weakness, but, as some of our products have lost out to foreign goods, others embodying advanced research and technology have continued to gain new markets. Such shifts in the composition of a country's foreign trade are not unusual, representing as they do the free market adjustment to changes in the productive structure of individual countries that make first one country and then another excel in this or that product.

What seems to have happened is that the shifts in comparative advantage in the postwar period have been so rapid that many of the necessary adjustments here have lagged behind. An examination of the statistical record of the recent past, however, shows no serious deterioration in the competitive position of United States manufactures as a whole. Our share of world exports of manufactures, it is true, has declined, but only slightly, and the decline appears to have been to an important degree in response to the comeback of West Germany and Japan (see Chart 15). Moreover, and perhaps surprisingly, comparisons of price and labor-cost changes in recent years reveal that overall percentage increases in United States prices have been no larger than in other industrial countries, while United States wage rates and labor costs in manufacturing have actually increased less percentagewise than in the other countries. The change has come instead from a rapid expansion abroad of capacity to produce those goods for which the absolute level of costs has long been lower, or at least no higher, there than here. American producers no longer have the advantage of being able to quote earlier delivery dates than their competitors,

EXPORT SHARES. The United States share of industrial countries' manufactured exports has declined in the past decade, primarily because of the comeback of West Germany and Japan, but it remains higher than prewar.

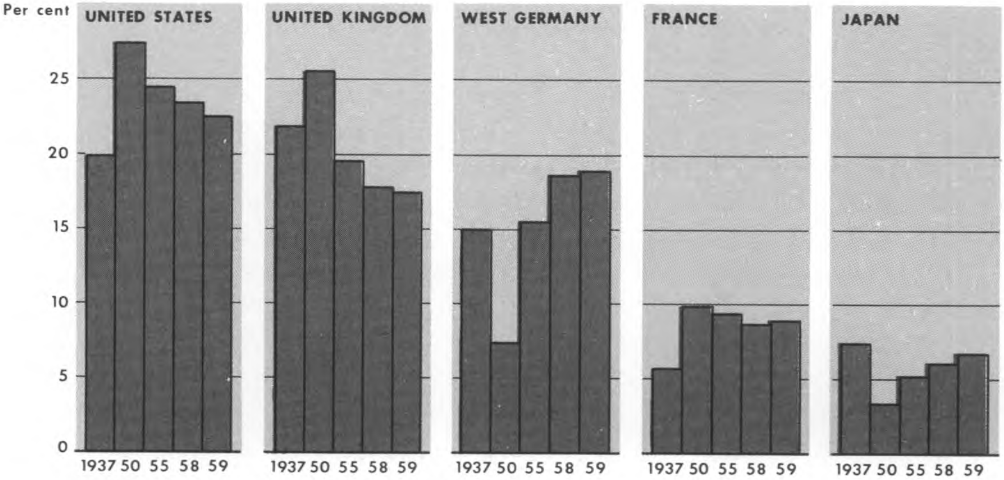


CHART 15

Note: Data for 1959 partly estimated.

nor of being able to offer standard items which others were not even equipped to produce. Instead of having foreign customers clamoring for its products more or less indiscriminately, United States industry must now devote the same efforts to meeting competition abroad as it does at home. This is a lesson that other countries, under the pressure of circumstances, learned much earlier than could have been expected of the United States with its large domestic market. But today there is a real need for American ingenuity to develop designs and products, as well as production, selling, and servicing methods, that will meet a favorable response abroad. There will have to be flexibility and mobility, on the part of both management and labor, if the need is to be met effectively.

Meanwhile, of course, United States imports have exhibited a steady long-term growth that appears to have been faster than the uptrend of exports. The lifting of the consumer horizon to include more and more foreign goods, the reductions in tariffs, as well as the growing need for foreign raw materials, have all spurred this growth. United States imports remain low in relation to domestic production, when compared with pre-World War I years or with other countries, but the rapid import expansion may well continue in the years ahead, a possibility that makes a determined export drive all the more imperative.

The New World Economy

THE CHANGING TRADE AND PAYMENTS SYSTEM. The emergence of large United States balance-of-payments deficits in the last two years is but one sign of the recent transformation of the world economy. By 1959 it had become clear that the era of postwar discriminatory restrictions on international trade and payments was drawing to a close. The easing of restrictions dates back, of course, to the early 1950's and the waning of the world-wide inflationary boom that had followed the outbreak of the Korean war. By that time Western Europe had become economically strong enough to begin dismantling the whole cumbersome apparatus of control. However, the renewed inflationary pressures that beset Europe in 1955-57, the Middle East political difficulties, and the related European balance-of-payments crises obscured the extent of Europe's recovery and interrupted the advance toward a freer payments system.

The advance was resumed in 1958, and the successful establishment of nonresident convertibility of most Western European currencies at the end of that year brought general recognition that financial reasons for dollar discrimination had disappeared. During 1959 a great many countries in Western Europe and elsewhere joined those that had already removed virtually all discriminatory trade controls, or announced additional plans to do so. Some discriminatory controls on so-called invisible transactions, and even on some capital movements, as well as many general quantitative restrictions on trade and payments, were also abolished. As a result, world trade has moved steadily toward economically more rational channels, although freedom from quota restrictions is still far from universal. The lifting of quota restrictions, of course, has shifted attention to existing tariff barriers, and in many instances these remain a major hindrance to further trade expansion. The world-wide program for reciprocal tariff negotiation and reduction within the framework of GATT (the General Agreement on Tariffs and Trade) has thus become more important than ever.

The easing of restrictions on the international movement of capital, together with the restored strength of Western Europe, has enlarged the scope for movements of short-term funds from one country to another in response to interest rate differentials. Such movements, of course, could worsen rather than relieve payments imbalances. However, recent shifts of funds have generally helped to balance world payments. While a world money market is rapidly re-emerging, the integration of long-term capital markets on the other hand remains much less advanced.

Along with the removal of many trade and payments restrictions, foreign countries were able in 1959 to join with the United States in strengthening the world payments system through various financial measures. The most significant of these was the enlargement of the resources of the two Bretton Woods institutions, the International Monetary Fund and the International Bank for Reconstruction and Development. The general 50 per cent increase in Fund quotas, plus higher increases for a number of countries, augmented that institution's resources by about $5 billion, of which $1.2 billion was in gold. International liquidity was increased, not only through the enlargement of quotas, but also by the greater usability of the newly convertible European currencies contributed to the Fund.

The doubling of the authorized capital of the International Bank was the major step forward in the field of long-term development financing. At the same time, the Bank's ability to harness private funds for long-term economic development was strengthened through greater reliance upon borrowing in capital markets outside the United States. Such borrowing remained relatively small in 1959, but it promised to be significant as a means of channeling European capital to nonindustrial countries. The contribution of foreign industrial countries to the development of the raw-material-producing countries may also be enhanced through the proposed International Development Association. This affiliate of the International Bank, which if approved by the member countries would come into existence late in 1960, is designed to finance sound projects of high priority that cannot fully meet the strict lending standards of the International Bank or qualify for equity financing through the International Finance Corporation (which also notably expanded its fledgling operations over the past year). Three other international lending organizations—of a regional rather than world-wide character—appeared in 1959. Both the European Investment Bank and the Overseas Development Fund of the European Common Market actually began operations, while the charter of the Inter-American Development Bank was ratified during the year.

Alongside all these moves toward a freer and stronger payments system, two new potential problem areas came to the fore in 1959—the emergence of regional economic groupings and the intensification of the Soviet bloc's trade drive. The increased trend toward regionalism in trade seems likely to have a major impact on the future of the Free World economy. In Africa and Asia, to be sure, this trend has barely begun, but in Latin America the formation of regional groupings has already advanced to the blueprint stage, and in Europe it is well on the way to actual implementation. These regional arrangements promise freer and larger markets to their participants, but their very nature implies that their immediate benefits can be extended only to member countries. Whether or not such regional arrangements will speed the integration of the entire world economy will depend on how liberally these new groupings conduct their commercial policies with the outside world. The announced readiness of the European Common Market to negotiate substantial tariff reductions with the outside world is a hopeful augury.

The second major problem confronting the Free World economy arose from the Soviet bloc's trade drive. Centrally directed, employing monopolistic practices, aimed at political as well as economic objectives, and directed currently toward a selected group of countries, this offensive could undermine the independence of some of the Soviet bloc's trading partners in the Free World. However, the power of the bloc over those countries that trade with it varies inversely with the availability of alternative markets, sources of goods, and terms of financing. Few members of the Free World community are likely to become seriously dependent on the Soviet bloc provided—and the proviso is important—that Western markets, especially in the industrial countries, are expanding and barriers to trade are being reduced, and the West continues its policy of helping in the diversification and development of the economies of the primary producers.

FOREIGN ECONOMIES IN THE PROCESS OF CHANGE. Perhaps the most striking aspect of the transformation of foreign economies that has made possible the strengthening of the world payments system is the apparent waning of the pervasive inflationary forces that had gripped the world since World War II. Not only has the postwar recovery of the industrial countries now been completed and the surplus money supply inherited from the war absorbed, but monetary and fiscal authorities—with the increasing support of public opinion—have become more than ever determined to prevent inflation. In country after country the imposition of monetary and other restraint measures during the early stages of the 1959 expansion showed this clearly. Similarly, in most countries where inflationary problems had long persisted, the necessity of comprehensive stabilization programs has become widely accepted.

With the solution of the immediate postwar problems, the countries of the Free World were able in 1959 to devote greater attention to longer term economic issues. Growth without inflation has become generally recognized as a major economic task facing the Free World. A number of industrial countries abroad introduced a variety of measures in 1959 to stimulate private savings and investment, primarily through tax incentives of one kind or another. More important have been the dismantling of remaining direct controls and the introduction and strengthening of legislation to encourage the working of competitive market forces as the best means to assure steady growth. It is significant—and in rather sharp contrast to some opinion in this country—that inflation, creeping or otherwise, is not widely viewed abroad as the way to rapid growth. Opposition to inflation of any shape or size is virtually unanimous in the industrial countries abroad, and is growing steadily in the nonindustrial ones. This difference in emphasis here and abroad clearly stems from foreign experience with inflation as well as from the fact that foreign economies for a long time have been forced to devote much greater attention to their balance of payments than has the United States. Postwar trends in other countries clearly confirm that price increases do not necessarily go hand in hand with economic growth and, where they do, rapid growth is usually at the expense of international reserves and therefore cannot be sustained.

The recent changes in the economic climate abroad have been most marked in the countries of Western Europe. Significantly, France came to share more fully in Europe's new dynamism, as a markedly successful stabilization program—achieved despite the continued drain caused by the Algerian conflict—halted the damage that inflation had for years been inflicting on an otherwise strong economy. Amid a new emphasis on free markets, a shift toward a high-consumption economy has begun and is accelerating throughout Western Europe. This shift is being supported by a rapid spread of consumer credit and, in a fashion reminiscent of the American scene of a generation ago, is creating mass markets that will support mass production. The trend toward higher wages seems to have gathered speed, but labor productivity too has grown rapidly, particularly helped by marked advances in technology and by sizable outlays for new plant and equipment.

In the nonindustrial countries, progress has not been so encouraging. Lately, the policies of most of these countries, notably in Latin America, have placed stronger emphasis on price stability, greater reliance on their own efforts, and more favorable treatment of private foreign investment, all necessary conditions for rapid economic advance. But the tasks these countries face remain immense. The adverse shift in their terms of trade in recent years has offset some of the aid that they received from the United States and other industrial countries. Not surprisingly, therefore, the primary-producing countries continue to press for commodity price stabilization arrangements. One aspect of the advance of the less developed regions toward industrialization, however, has not received as much attention as it deserves. An increasing number of the poorer countries are reaching the stage where they are beginning to offer manufactured goods, especially the simpler textiles, on world markets. This new competition with the older industrial countries may well intensify complaints against "cheap foreign labor". It is clear, however, that if the Free World economy is to continue to grow, with maximum advantage to consumers, it must be flexible enough to take in stride the continuing shifts in production required by the old but still valid principle of comparative advantage.

The Challenges of the Sixties

The world economy has changed its appearance so rapidly over the last two years, as the forces of liberal trade have begun to reach fruition, that attention has only begun to focus upon the new problems and opportunities in the Free World.

The development of the poorer regions of the Free World has now been generally accepted as a responsibility that all the older industrial regions must jointly shoulder along with the nonindustrial regions. It is a task, moreover, that will be with us for a long time to come. The need for a steady growth of the industrial countries, in order both to continue to lift domestic living standards and to contribute to the development of the nonindustrial countries, is likewise a continuing one. The particular measures to be taken to deal with these problems are bound to be many and varied. But monetary and fiscal soundness, as well as a liberal trading framework, are prerequisites for continued expansion of the Free World economy.

The same precepts also apply to this country's payments difficulties. Although our gold stock of $19½ billion—half of the Free World's monetary gold—remains sizable, a continuation of United States deficits at their recent rate clearly cannot be tolerated. Industrial countries abroad, their economic strength restored, can help not only through the further removal of trade and payments restrictions but also through an increased sharing with the United States of both defense and development burdens. But these countries' cooperation alone is not enough. Our political-economic obligations to friends and allies around the globe make an especially large payments surplus on private account essential. Basically, however, our new problem is one that has long confronted the rest of the world—the discipline of the balance of payments cannot be avoided. This does not mean that balance-of-payments considerations now should be the only guide for the United States economy. But they do have an important bearing on domestic policies. Both our international and our domestic positions make imperative what should be obvious in any case: inflation with its resulting cost and price advances must be avoided.

THIS BANK'S OPERATIONS

Volume and Trend of the Bank's Operations

DOMESTIC OPERATIONS. For most departments of the Bank, the volume of operations expanded appreciably in 1959, reflecting higher levels of business and financial activity and a more intensive use of available funds.

During the year, the Bank processed 571 million checks amounting to $394 billion, excluding United States Government checks. This represented an increase of 3 per cent in the number of items handled but only a very slight rise in dollar volume over the preceding year. The leveling-off in dollar volume stemmed chiefly from a change in the procedures for effecting transfers of funds among New York City banks; some banks that used to make payments by drawing checks on this Bank switched instead to using the Bank's wire transfer facilities. As a result, the dollar volume of checks drawn on this Bank, which is included in the above total, declined by $11 billion (or 6 per cent) from 1958 to 1959, reversing the upward trend of recent years. In contrast, the dollar volume of checks handled other than those drawn on this Bank rose by nearly $12 billion to $228 billion. This represented about one fifth of the total for all twelve Federal Reserve Banks. Paralleling the rise in check volume, the average level of float at this Bank in 1959 was 4 per cent higher than in 1958.

The number of United States Government checks handled by the Bank during 1959 increased by 3 per cent, compared with declines of 7 and 9 per cent in 1957 and 1958, respectively. No major changes were made during 1959 in the Treasury's payment and reconciliation procedures, whereas certain simplifications had been instituted in 1957 and 1958 which largely accounted for the reduced volume in those years. The dollar value of Government checks collected through this Bank rose 5 per cent in 1959 over 1958.

Use of the Bank's wire transfer facilities increased substantially further in 1959. The dollar volume of transfers, other than Treasury transfers and Reserve Bank interdistrict settlements, totaled $685 billion, a rise of 14 per cent over 1958. Partly, the rise reflected the more frequent use of these facilities in local transfers of funds, as described above. The actual number of transfers handled in 1959 was about 564,000, up 11 per cent from 1958.

MEMBER BANK BORROWINGS. Borrowing from this Bank jumped sharply in 1959. While both the total and average daily amounts were less than in 1956 and 1957, the proportion of member banks using the discount window was the highest in recent years.

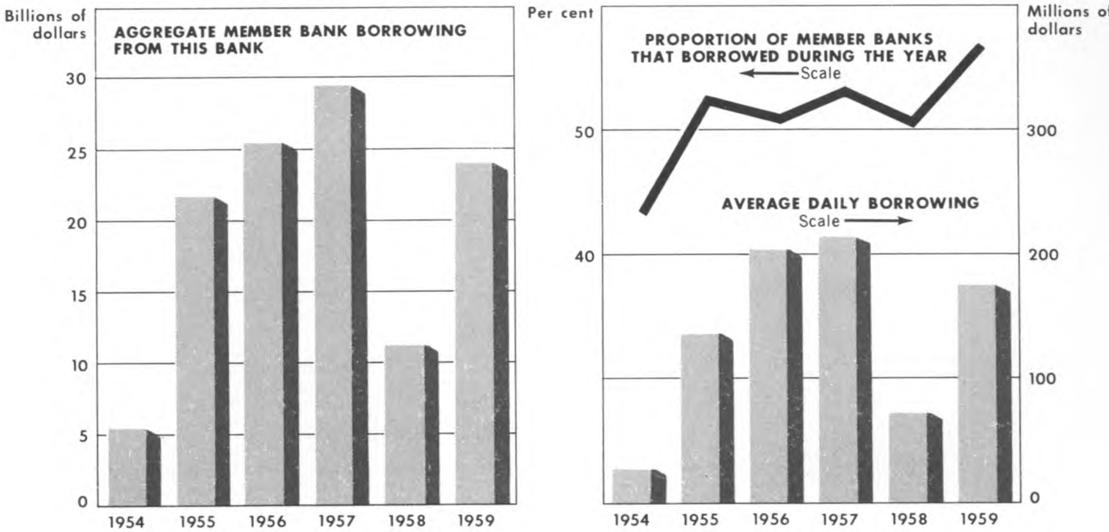


CHART 16

A further marked expansion in the Treasury's financing operations, and the continuing high level of activity in the Government securities market, caused the Bank's fiscal agency operations to increase significantly during 1959. The dollar volume of all Government obligations, other than United States Savings bonds, processed by this Bank in 1959 was $453 billion, an increase of 9 per cent over 1958. The number of pieces handled during 1959 rose even more rapidly than the dollar volume, jumping by 22 per cent to 6½ million. Part of the rise reflected the unusually heavy participation of small investors in the Treasury issue of 5 per cent notes in October; the Bank handled about 200,000 of these notes.

One of the most impressive changes in the Bank's operations during 1959 was the sharp rise in lending activities, as mounting pressures on reserve positions caused member banks to turn more frequently and in greater volume to the "discount window". As shown in Chart 16, the dollar volume of advances to member banks more than doubled in 1959, rising to $24 billion. Although the 1959 total was somewhat less than those for 1956 and 1957, the proportion of member banks that borrowed at least once during the year was the highest in recent years.

SOME MEASURES OF THE VOLUME OF OPERATIONS OF

THE FEDERAL RESERVE BANK OF NEW YORK (Including Buffalo Branch)

Number of pieces handled ★	**1959**	**1958**
Discounts and advances	3,221	2,087
Currency received and counted	1,270,092,000	1,249,986,000
Coin received	2,227,233,000	2,165,780,000
Gold bars and bags of gold coin handled	374,000	292,000
Checks handled:		
United States Government checks	56,391,000	54,675,000
All other	570,981,000	552,224,000
Postal money orders handled	39,664,000	43,037,000
Collection items handled:		
United States Government coupons paid	4,045,000	4,003,000
Credits for direct sendings of collection items	369,000	359,000
All other	12,508,000	12,115,000
Issues, redemptions, exchanges by fiscal agency departments:		
United States Savings bonds	28,716,000	28,501,000
All other United States obligations	6,440,000	5,266,000
Obligations of the International Bank for Reconstruction and Development	249,000	701,000
Safekeeping of securities:		
Pieces received and delivered	8,480,000	7,368,000
Coupons detached	3,746,000	3,342,000
Wire transfers of funds†	564,000	509,000
Amounts handled		
Discounts and advances	$24,013,712,000	$11,072,095,000
Currency received and counted	8,428,367,000	8,165,085,000
Coin received	236,324,000	226,977,000
Gold bars and bags of gold coin handled	4,989,551,000	4,062,503,000
Checks handled:		
United States Government checks	20,261,470,000	19,261,007,000
All other	394,316,782,000	393,860,426,000
Postal money orders handled	688,790,000	733,765,000
Collection items handled:		
United States Government coupons paid	2,058,555,000	2,087,965,000
Credits for direct sendings of collection items	704,297,000	702,094,000
All other	1,914,776,000	1,989,532,000
Issues, redemptions, exchanges by fiscal agency departments:		
United States Savings bonds	2,198,387,000	2,251,751,000
All other United States obligations	452,875,309,000	414,542,707,000
Obligations of the International Bank for Reconstruction and Development	703,840,000	1,134,564,000
Safekeeping of securities:		
Par value pieces received and delivered	619,894,323,000	580,961,706,000
Wire transfers of funds†	685,024,466,000	598,770,651,000

★Two or more checks, coupons, etc., handled as a single item are counted as one "piece".

† Includes a small amount of mail transfers; excludes Treasury transfers and Reserve Bank interdistrict settlements.

Notwithstanding the sizable increases in work volume, the average number of employees at the Bank in 1959 was actually slightly lower than in 1958. The decline was accounted for by a reduction in the number of short-hour and part-time workers, while the number of regular employees increased slightly. At the end of the year, the Bank's officers and staff numbered 3,853, including 245 at the Buffalo Branch.

FOREIGN AND INTERNATIONAL OPERATIONS. A counterpart of the United States balance-of-payments deficit in 1959 was a rise in gold and dollar assets held for foreign account by this Bank (on behalf of all Federal Reserve Banks) of about $1.3 billion over the year to a new high of $13.4 billion. The increase in 1959 was much less than the $2.2 billion rise during 1958, however. While all types of assets held for foreign account shared in the rise in 1959, holdings of United States Government securities, which had registered a small decline in 1958, accounted for most of the increase, climbing by $0.8 billion to $4.5 billion. Earmarked gold, on the other hand, increased by only $0.4 billion to $8.0 billion, compared with a rise of $2.2 billion in 1958. (Total gold custody, including international accounts, was $9.9 billion at the end of 1959.) Other changes during 1959 were relatively slight.

The accounts of international organizations (in which the other Federal Reserve Banks do not participate) rose sharply by $2.8 billion during 1959, bringing the assets held by this Bank for international accounts to a new high of almost $6 billion. This large expansion chiefly reflected the increase in member country quotas in the International Monetary Fund (discussed earlier in this *Report*).

There was only moderate activity in loans on gold during 1959. New arrangements were made with four foreign monetary authorities, involving about $41 million. At the year end only one loan, of $5 million, was outstanding. It is this Bank's policy to make loans on gold, and commitments for such loans, to foreign monetary authorities to assist them in meeting seasonal and other temporary dollar drains.

Five new accounts were opened during the year, for the Italian Foreign Exchange Office, the European Investment Bank, the Bank of Taiwan, and the recently organized central banks of Tunisia and Malaya.

Financial Statements

STATEMENT OF EARNINGS AND EXPENSES FOR THE CALENDAR YEARS 1959 AND 1958 (In thousands of dollars)

	1959	1958
Total current earnings	224,372	188,059
Net expenses	29,008	28,139
Current net earnings	195,364	159,920
Additions to current net earnings:		
Profit on sales of United States Government securities (net)	48	39
Transferred from reserve for contingencies (net)	20,969★	0
All other	1	12
Total additions	21,018	51
Deductions from current net earnings:		
Transferred to reserve for contingencies	0	49
All other	288	1
Total deductions	288	50
Net additions	20,730	1
Net earnings before payments to United States Treasury	**216,094**	**159,921**
Dividends paid	6,547	6,200
Paid United States Treasury (interest on Federal Reserve notes)	227,544	138,349
Transferred to surplus	−17,997	15,372
Surplus Account (Section 7):		
Surplus—beginning of year	238,902	223,963
Transferred from net earnings for year	0	15,372
	238,902	239,335
Paid United States Treasury (interest on Federal Reserve notes)	17,997†	0
Paid United States Treasury (pursuant to Small Business Investment Act of 1958)	0	433
Surplus - end of year	**220,905**	**238,902**

★ Represents $21,026,000 transferred from reserve for contingencies less annual addition to reserve for registered mail losses of $57,111.

† Payment to United States Treasury representing surplus in excess of 100 per cent of subscribed capital stock as of December 31, 1959.

STATEMENT OF CONDITION

(In thousands of dollars)

Assets	DEC. 31, 1959	DEC. 31, 1958
Gold certificates	4,685,959	5,277,366
Redemption fund for Federal Reserve notes	213,326	198,412
Federal Reserve notes of other Banks	90,056	83,865
Other cash	54,975	60,901
Total cash	5,044,316	5,620,544
Discounts and advances	202,780	11,568
Acceptances	75,341	49,089
United States Government securities	6,737,161	6,714,791
Total loans and securities	7,015,282	6,775,448
Other assets:		
Due from foreign banks★	4	4
Cash items in process of collection	1,280,699	1,215,353
Bank premises	9,858	10,313
All other	65,067	36,478
Total other assets	1,355,628	1,262,148
Total Assets	**13,415,226**	**13,658,140**

★ After deducting participation of other Federal Reserve Banks amounting to about $11,000 in both 1958 and 1959.

STATEMENT OF CONDITION

(In thousands of dollars)

Liabilities	DEC. 31, 1959	DEC. 31, 1958
Federal Reserve notes	6,646,973	6,512,632
Deposits:		
Member bank — reserve accounts	5,092,824	5,570,787
United States Treasurer — general account	65,278	35,307
Foreign★	94,228	103,755
Other	367,074	307,036
Total deposits	5,619,404	6,016,885
Other liabilities:		
Deferred availability cash items	808,203	755,659
All other	7,452	5,375
Total other liabilities	815,655	761,034
Total Liabilities	**13,082,032**	**13,290,551**
Capital Accounts:		
Capital paid in	110,452	105,850
Surplus	220,905†	238,902
Other capital accounts	1,837	22,837
Total Capital Accounts	**333,194**	**367,589**
Total Liabilities and Capital Accounts	**13,415,226**	**13,658,140**
Contingent liability on acceptances purchased for foreign correspondents‡	22,750	19,119
Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities combined	39.9%	43.7%

★ After deducting participation of other Federal Reserve Banks amounting to	250,560	168,730
† After payment to United States Treasury of $17,997,293, representing surplus in excess of 100 per cent of subscribed capital stock as of December 31, 1959.		
‡ After deducting participation of other Federal Reserve Banks amounting to	59,256	48,680

Changes in Membership

During 1959 the total number of commercial banks in this District that are members of the Federal Reserve System declined from 531 to 507. The net decrease of 24 banks was the result of mergers of 25 member banks with other banks and the admission of one State bank to membership. The 507 banks constitute 86 per cent of all national banks, State banks, and trust companies in this District and hold 96 per cent of the total assets of all such institutions in this District.

NUMBER OF OPERATING MEMBER AND NONMEMBER BANKS IN SECOND FEDERAL RESERVE DISTRICT AT THE YEAR END
(Exclusive of savings banks, private bankers, and industrial banks)

	DECEMBER 31, 1959			DECEMBER 31, 1958		
Type of Bank	**Members**	**Non-members**	**Per cent members**	**Members**	**Non-members**	**Per cent members**
National banks	349★	0	100	366★	0	100
State banks and trust companies	158	82	66	165	85	66
Total	**507★**	**82**	**86**	**531★**	**85**	**86**

★ Includes one national bank located in the Virgin Islands.

CHANGES IN FEDERAL RESERVE MEMBERSHIP IN SECOND DISTRICT DURING 1959

Total membership at the beginning of the year	**531**
Increases:	
Nonmember State bank admitted	1
Decreases:	
Member banks combined with other members	21
Member banks combined with nonmembers	4
Total membership at the year end	**507**

Changes in Directors and Officers

CHANGES IN DIRECTORS. In December 1959 member banks in Group 2 elected César J. Bertheau, Chairman of the Board of the Peoples Trust Company of Bergen County, Hackensack, New Jersey, a Class A director of the Federal Reserve Bank of New York for a term of three years beginning January 1, 1960. He succeeded Charles W. Bitzer, Chairman of the City Trust Company, Bridgeport, Connecticut, whose term expired December 31, 1959.

At the same time, member banks in Group 2 elected Kenneth H. Hannan, Executive Vice President of Union Carbide Corporation, New York, N. Y., a Class B director for a term of three years beginning January 1, 1960. He succeeded Lansing P. Shield, President of The Grand Union Company, East Paterson, New Jersey, whose term expired December 31, 1959. Mr. Shield died on January 6, 1960.

Also in December 1959, the Board of Governors of the Federal Reserve System appointed Philip D. Reed, former Chairman of the Board of General Electric Company, New York, N. Y., a Class C director of this Bank for the three-year term beginning January 1, 1960 and designated him as *Chairman* of the Board of Directors and *Federal Reserve Agent* for the year 1960. Mr. Reed had been serving as a Class B director of this Bank since January 1, 1959 and resigned to accept appointment as a Class C director. He succeeded John E. Bierwirth, Chairman of National Distillers and Chemical Corporation, New York, N. Y., whose term expired December 31, 1959. At the same time, the Board of Governors reappointed Forrest F. Hill, Vice President of The Ford Foundation, New York, N. Y., as *Deputy Chairman* of the Board of Directors for the year 1960.

At the Buffalo Branch of the Federal Reserve Bank of New York, in November 1959, Thomas E. LaMont, farmer of Albion, Orleans County, N. Y., was appointed by the Board of Governors of the Federal Reserve System a director of the Buffalo Branch of this Bank for the unexpired portion of the term ending December 31, 1960. He succeeded Cameron G. Garman, fruit grower of Burt, Niagara County, N. Y., who died on October 17, 1959. In December 1959 the Board of Governors reappointed Raymond E. Olson, President of Taylor Instrument Companies, Rochester, N. Y., a director of the Buffalo Branch for the three-year term beginning January 1, 1960. Also in December 1959, the Board of Directors of the Federal Reserve Bank of New York designated Whitworth Ferguson, President of Ferguson Electric Construction Co., Inc., Buffalo, N. Y., as *Chairman* of the Board of Directors of the Buffalo Branch for the year 1960. At the same time, the Board of Directors of this Bank appointed Howard N. Donovan, President of the Bank of Jamestown, Jamestown, N. Y., a director of the Branch for the three-year term beginning January 1, 1960. He succeeded Vernon Alexander, President of The National Bank of Geneva, Geneva, N. Y., whose term expired December 31, 1959.

CHANGES IN OFFICERS. Since February 1959, six officers retired and two resigned:

A. Chester Walton, Manager of the Bank Relations Department, retired effective February 1, 1959. Mr. Walton had completed almost forty years of service with the Bank and had been an officer since January 1951.

Harold V. Roelse, Vice President and Economic Adviser, retired effective March 1, 1959. Mr. Roelse had been an officer of the Bank since 1928, and for more than three decades, along with his other duties, guided the preparation of this Bank's *Annual Report*. Mr. Roelse died on January 22, 1960.

Valentine Willis, Vice President in charge of the Cash and Collections function, retired effective March 1, 1959. Mr. Willis had been a member of the Bank's staff since October 1917 and an officer since April 1933.

John Exter, Vice President assigned to the Foreign function, resigned, effective May 1, 1959, to become Vice President of The First National City Bank of New York. Mr. Exter had been with the Bank since September 1954.

Gregory O'Keefe, Jr., Assistant Counsel, who had been an officer of the Bank since May 1953, resigned effective July 16, 1959.

Reginald B. Wiltse, Vice President in charge of the Bank Supervision and Relations function, retired effective February 1, 1960. Mr. Wiltse had served with the Federal Reserve System for forty-one years and had been an officer of this Bank since February 1928.

William A. Heinl, Manager of the Security Custody Department, retired effective February 1, 1960. Mr. Heinl had been in the employ of the Bank since August 1917 and an officer of the Bank since January 1942.

Harding Cowan, Assistant Counsel, retired effective February 1, 1960. Mr. Cowan had been a member of the Bank's staff since July 1940 and an officer since January 1951.

The following additional changes in official staff have taken place since February 1959:

Marcus A. Harris, Vice President, was assigned to the Cash and Collections function, effective March 1, 1959, to succeed Mr. Willis.

Charles A. Coombs, formerly Assistant Vice President assigned to the Research and Statistics function, was appointed Vice President and assigned to the Foreign function, with senior responsibility for the administration of that function, effective May 1, 1959.

Horace L. Sanford, formerly Assistant Vice President assigned to the Foreign function, was appointed Vice President, effective May 1, 1959, continuing in the Foreign function, with supervisory responsibility for the operations of that function and special responsibility for Latin American affairs.

Peter P. Lang, formerly Manager of the Foreign Department, was appointed Adviser, effective May 1, 1959, and assigned to the Foreign function to conduct special assignments over the entire range of the function's responsibilities.

Thomas J. Roche, formerly Foreign Exchange Officer, was appointed Manager and assigned to the Foreign Department, effective May 1, 1959, to succeed Mr. Lang.

John P. Jensen, formerly Manager of the Accounting Department, was appointed Assistant General Auditor, effective May 7, 1959. Mr. Jensen was reappointed Manager, effective January 7, 1960, and assigned to the Government Bond and Safekeeping Department.

Frank W. Schiff, formerly Senior Economist in the Research and Statistics function, was appointed Manager, effective May 7, 1959, and assigned to the Research Department. Mr. Schiff was reappointed Senior Economist, effective January 7, 1960.

Tilford C. Gaines, Manager, formerly assigned to the Securities Department, was assigned to the Research Department, effective May 8, 1959. Mr. Gaines was appointed Assistant Vice President, effective January 7, 1960, and assigned to the Research and Statistics function.

Alan R. Holmes, Manager, formerly assigned to the Research Department, was assigned to the Securities Department, effective May 8, 1959.

Howard D. Crosse, formerly Assistant Vice President in the Bank Supervision and Relations function, was appointed Vice President, to succeed Mr. Wiltse, effective January 1, 1960.

Fred W. Piderit, Jr., formerly Manager of the Bank Relations Department, was appointed Assistant Vice President, effective January 7, 1960, and was assigned to the Bank Supervision and Relations function.

Martin W. Bergin, formerly Special Assistant in the Personnel Department, was appointed Manager, effective January 7, 1960, and assigned to the Security Custody Department.

Karl L. Ege, formerly Chief of the Auditing Division, Auditing Department, was appointed Assistant General Auditor, effective January 7, 1960.

Fred H. Klopstock, formerly Chief of the Financial and Trade Statistics Division, Research Department, was appointed Manager, effective January 7, 1960, and assigned to the Research Department.

Aloysius J. Stanton, formerly Special Assistant in the Planning Department, was appointed Manager, effective January 7, 1960, and assigned to the newly created Check Mechanization Department in the Cash and Collections function.

Robert W. Stone, Manager of the Securities Department, was appointed also Assistant Secretary, effective January 7, 1960, the appointment of Carl H. Madden, Manager of the Public Information Department, as Assistant Secretary being discontinued on the same date.

Robert C. Thoman, formerly Special Assistant in the Bank Relations Department, was appointed Manager, effective January 7, 1960, and assigned to the Bank Relations Department.

Thomas M. Timlen, Jr., formerly an Attorney in the Legal Department, was appointed Assistant Counsel, effective January 7, 1960.

Robert Young, Jr., formerly an Attorney in the Legal Department, was appointed Assistant Counsel, effective January 7, 1960.

William F. Palmer, Manager, formerly assigned to the Government Bond and Safekeeping Department, was assigned to the Cash Custody Department, effective January 8, 1960.

Everett B. Post, Manager, formerly assigned to the Personnel Department, was assigned to the Accounting Department, effective January 8, 1960.

Charles R. Pricher, Manager, formerly assigned to the Collection Department, was assigned to the Personnel Department, effective January 8, 1960.

Walter S. Rushmore, Manager, formerly assigned to the Cash Custody Department, was assigned to the Collection Department, effective January 8, 1960.

Madeline H. McWhinney, formerly Special Assistant in the Research Department, was appointed Manager and assigned to the newly created Market Statistics Department in the Research and Statistics function, effective January 21, 1960.

MEMBER OF FEDERAL ADVISORY COUNCIL—1960. The Board of Directors of this Bank selected John J. McCloy to serve during 1960, for the second successive year, as the member of the Federal Advisory Council representing the Second Federal Reserve District. Mr. McCloy is Chairman of the Board of The Chase Manhattan Bank, New York, N. Y.

MEMBERS OF INDUSTRIAL ADVISORY COMMITTEE. Two members of the Industrial Advisory Committee for the Second Federal Reserve District died around the beginning of 1959: Edward J. Noble, Chairman of the Finance Committee of American Broadcasting-Paramount Theatres, Inc., New York, N. Y., on December 28, 1958, and William H. Pouch, Chairman of the Board of Concrete Steel Company, New York, N. Y., on February 16, 1959. Mr. Noble had served continuously as a member of the committee since 1935 (with the exception of nine months in 1940 when he was engaged in Government service). Mr. Pouch was an original member of the committee appointed June 1934 and had served as its chairman since July 1934. The term of Arthur G. Nelson, Chairman of the Board of A. G. Nelson Paper Company, Inc., New York, N. Y., expired on February 28, 1959. Mr. Nelson became a member of the committee in December 1934 and had served continuously since that time. In view of the inactivity under Section 13b of the Federal Reserve Act and the fact that that section was repealed by Congress, effective August 21, 1959, no successors were appointed.

Directors of the Federal Reserve Bank of New York

DIRECTORS	Term expires Dec. 31	Class	Group
HENRY C. ALEXANDER Chairman of the Board, Morgan Guaranty Trust Company of New York, New York, N. Y.	1961	A	1
CÉSAR J. BERTHEAU Chairman of the Board, Peoples Trust Company of Bergen County, Hackensack, N. J.	1962	A	2
CYRUS M. HIGLEY President and Trust Officer, The Chenango County National Bank and Trust Company of Norwich, Norwich, N. Y.	1960	A	3
VACANCY	1961	B	1
KENNETH H. HANNAN Executive Vice President, Union Carbide Corporation, New York, N. Y.	1962	B	2
AUGUSTUS C. LONG Chairman, Board of Directors, Texaco Inc., New York, N. Y.	1960	B	3
PHILIP D. REED, *Chairman, and Federal Reserve Agent* Former Chairman of the Board, General Electric Company, New York, N. Y.	1962	C	
FORREST F. HILL, *Deputy Chairman* Vice President, The Ford Foundation, New York, N. Y.	1960	C	
JAMES DECAMP WISE Chairman of the Board, Bigelow-Sanford Carpet Company, Inc., New York, N. Y.	1961	C	

DIRECTORS — BUFFALO BRANCH

WHITWORTH FERGUSON, *Chairman* President, Ferguson Electric Construction Co., Inc., Buffalo, N. Y.	1961
THOMAS E. LAMONT Farmer, Albion, Orleans County, New York	1960
E. PERRY SPINK President, Liberty Bank of Buffalo, Buffalo, N. Y.	1960
DENTON A. FULLER President, The Citizens National Bank of Wellsville, Wellsville, N. Y.	1961
JOHN W. REMINGTON President, Lincoln Rochester Trust Company, Rochester, N. Y.	1961
HOWARD N. DONOVAN President, Bank of Jamestown, Jamestown, N. Y.	1962
RAYMOND E. OLSON President, Taylor Instrument Companies, Rochester, N. Y.	1962

MEMBER OF FEDERAL ADVISORY COUNCIL — 1960

JOHN J. MCCLOY Chairman of the Board, The Chase Manhattan Bank, New York, N. Y.	1960

Officers of the Federal Reserve Bank of New York

ALFRED HAYES, *President*

WILLIAM F. TREIBER, *First Vice President*

HAROLD A. BILBY, *Vice President*
CHARLES A. COOMBS, *Vice President*
HOWARD D. CROSSE, *Vice President*
MARCUS A. HARRIS, *Vice President*
HERBERT H. KIMBALL, *Vice President*
ROBERT V. ROOSA, *Vice President*
ROBERT G. ROUSE, *Vice President*
WALTER H. ROZELL, JR., *Vice President*
HORACE L. SANFORD, *Vice President*
TODD G. TIEBOUT, *Vice President and General Counsel*
*REGINALD B. WILTSE, *Vice President*

JOHN J. CLARKE, *Assistant General Counsel*
EDWARD G. GUY, *Assistant General Counsel*

FELIX T. DAVIS, *Assistant Vice President*
NORMAN P. DAVIS, *Assistant Vice President*
TILFORD C. GAINES, *Assistant Vice President*
GEORGE GARVY, *Adviser*
PETER P. LANG, *Adviser*
JOHN J. LARKIN, *Assistant Vice President*
ANGUS A. MACINNES, JR., *Assistant Vice President*
SPENCER S. MARSH, JR., *Assistant Vice President*
FRED W. PIDERIT, JR., *Assistant Vice President*
LAWRENCE E. QUACKENBUSH, *Assistant Vice President*
FREDERICK L. SMEDLEY, *Assistant Vice President*

THOMAS O. WAAGE, *Assistant Vice President*

MARTIN W. BERGIN, *Manager, Security Custody Department*
WILLIAM H. BRAUN, JR., *Secretary, and Assistant Counsel*
*HARDING COWAN, *Assistant Counsel*
CLIFTON R. GORDON, *Assistant Counsel*
*WILLIAM A. HEINL, *Manager, Security Custody Department*
ALAN R. HOLMES, *Manager, Securities Department*
JOHN P. JENSEN, *Manager, Government Bond and Safekeeping Department*
FRED H. KLOPSTOCK, *Manager, Research Department*
ROBERT G. LINK, *Manager, Research Department*
CARL H. MADDEN, *Manager, Public Information Department*
WILLIAM E. MARPLE, *Manager, Credit and Discount Department*
MADELINE H. MCWHINNEY, *Manager, Market Statistics Department*
HERBERT A. MUETHER, *Manager, Building Operating Department*
DONALD C. NILES, *Manager, Planning Department*
ARTHUR H. NOA, *Manager, Service Department*
WILLIAM F. PALMER, *Manager, Cash Custody Department*
FRANKLIN E. PETERSON, *Manager, Cash Department*
JOHN F. PIERCE, *Chief Examiner*
EVERETT B. POST, *Manager, Accounting Department*
CHARLES R. PRICHER, *Manager, Personnel Department*
JOHN P. RINGEN, *Manager, Bank Examinations Department*
THOMAS J. ROCHE, *Manager, Foreign Department*
WALTER S. RUSHMORE, *Manager, Collection Department*
FRANK W. SCHIFF, *Senior Economist*
THOMAS C. SLOANE, *Assistant Counsel*
KENNETH E. SMALL, *Manager, Savings Bond Department*
GEORGE C. SMITH, *Manager, Check Department*
ALOYSIUS J. STANTON, *Manager, Check Mechanization Department*
ROBERT W. STONE, *Manager, Securities Department, and Assistant Secretary*
ROBERT C. THOMAN, *Manager, Bank Relations Department*
THOMAS M. TIMLEN, JR., *Assistant Counsel*
ROBERT YOUNG, JR., *Assistant Counsel*

DONALD J. CAMERON, *General Auditor*
KARL L. EGE, *Assistant General Auditor*

*Retired February 1, 1960.

OFFICERS — BUFFALO BRANCH

INSLEY B. SMITH, *Vice President*

HAROLD M. WESSEL, *Assistant Vice President*

GEORGE J. DOLL, *Cashier*

GERALD H. GREENE, *Assistant Cashier*

M. MONROE MYERS, *Assistant Cashier*

THE SECOND FEDERAL RESERVE DISTRICT