ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

In making its thirty-second annual report, as required by law, the Board of Governors of the Federal Reserve System takes the first opportunity afforded, since the end of hostilities, to present to the Congress a general appraisal of the war's effects upon the country's monetary situation, viewed from the standpoint of the responsibilities which Congress has placed upon the System and the System's statutory powers to discharge these responsibilities.

It is the Board's belief that the implicit, predominant purpose of Federal Reserve policy is to contribute, in so far as the limitations of monetary and credit policy permit, to an economic environment favorable to the highest possible degree of sustained production and employment. Traditionally this over-all policy has been followed by easing credit conditions when deflationary factors prevailed and, conversely, by restrictive measures when inflationary forces threatened.

In common with other nations whose energies were devoted primarily to winning the victory, the United States had no choice, under the exigencies of a global war, except to use monetary powers in furtherance of essential war financing and not as an anti-inflationary weapon. There has been a widespread assumption that, with the coming of peace, such statutory powers as the Reserve System possesses should be exerted in the traditional way against the heavy inflationary forces at present confronting the country. The Board believes that such an assumption does not take sufficiently into account either the inherent limitations of the System's existing statutory powers, under present-day conditions, or the inevitable repercussions on the economy generally and on the Government's financing operations in particular of an exercise of such existing powers to the degree necessary to be an effective anti-inflationary influence.

Accordingly, the Board takes this occasion to review Government financing operations of the war years and at present as they have affected the country's banking and credit situation, and to outline, in general terms, some of the alternative measures to which the appropriate committees of the Congress may wish to give detailed consideration at the proper time, in determining by what means monetary and credit responsibilities should be discharged.

MONETARY SITUATION AS A RESULT OF WAR

Between June 30, 1940, on the eve of the defense program, and the end of 1945, the Government raised approximately 380 billion dollars. Of this, 153 billion dollars came from taxes, or about 40 per cent. The remainder, 228 billion, or about 60 per cent, was raised by borrowing, that is, by increasing the public debt. Of the total borrowed, 133 billion, or about 60 per cent of the borrowing, came from selling Government securities to investors other than commercial banks and the Federal Reserve Banks. Approximately 95 billion dollars, or 40 per cent, of the borrowing, was raised by selling Government securities to the commercial banking system.

It is important to any appraisal of monetary and credit conditions, to understand that borrowing from the banking system, whether by Government or by others, creates an equivalent addition to the country's monetary supply. Borrowing from individuals, business concerns, insurance companies, or other sources, except the banking system, represents the investment of existing savings. To the extent that the Government did not finance its war program by taxation, it was obliged to borrow, and to the extent that it did not borrow from nonbank investors, it relied upon the banks and thus created new supplies of money.

As a consequence, the country's money supply, as measured by demand deposits and currency in circulation, more than tripled, increasing from 40 billion dollars in June 1940 to 127 billion at the end of 1945. Time deposits nearly doubled in the same period and now amount to about 50 billion dollars. In addition, the general public (exclusive of banks, Government trust funds, insurance companies, and other financial institutions) has about 100 billion dollars of Government securities, eight times as much as in June of 1940.

From the monetary standpoint, it is necessary to take into account, not only these existing liquid assets, but also the amount of current income flowing from production and employment. All of these items compose an inflationary potential, at a time when the supply of goods and services available for purchase with existing funds and currently produced income is far from adequate to meet current demand, on which is superimposed an unprecedented backlog of demand accumulated in the war years. The extent to which funds available to the public, including business, will compete for the existing supply of goods and services depends upon many factors. It depends, among other things, upon the continuance and effectiveness of price controls, upon credit restraints and other devices for dealing with inflationary effects, and upon public psychology and behavior, which in turn are influenced by expectations as to the trend of prices and the volume of production. Public confidence that the purchasing power of savings and current earnings will be maintained depends primarily on the determination of Congress and of administrative officials to hold inflationary forces in check and to reduce them, wherever possible, until the country's unrivaled capacity to produce has had every opportunity to bring about a reasonable balance between the factors of supply and demand.

It is axiomatic that inflationary dangers exist when the supply of money in the hands of people who seek to spend it greatly exceeds the volume of goods and services available. The more the money supply exceeds the volume of goods, the greater the inflationary pressures will be. There can be no doubt that the country's money supply, several times greater now than ever before, is and will continue for an indefinite time to be much in excess of available goods. Under such conditions, with the heavy drains of war financing no longer existing, public policy calls for vigorous attack on the basic causes of inflationary pressures. This, in turn, requires that the Government stop and reverse, if possible, the process whereby it has created bank credit. It is all the more imperative that the Government reverse this process as the commercial banking system resumes its peacetime function of supplying credit to private sources whose borrowing will itself create additional funds.

The Government has, in fact, been reversing its creation of money by drawing on its surplus cash balance to pay off Government debt, primarily that held by the banks. As long as this use of the Treasury's cash balance continues, the effect will be anti-inflationary and altogether salutary at this time. However, if the policy of paying off Government debt is to continue, as it should until such time as deflationary and not inflationary pressures threaten economic stability, it will be essential to have not only a balanced budget but as great a surplus of receipts over expenditures as is possible without neglecting necessary governmental functions. Accordingly, further general reduction of taxes should be avoided and prudent economy should be effected in governmental operations.

Necessary as it is that Government policy be firmly anti-inflationary at this juncture, the rapid attainment of full and sustained production far overshadows all other economic considerations. As production is disrupted, whether by strikes or other causes, a series of interrelated and dangerous economic consequences inevitably results. On the one hand, supply is diminished relative to demand. On the other hand, demand is increased in so far as the public, anticipating rising prices, strives to purchase whatever can be obtained at whatever prices are asked or tolerated. Black markets, inventory accumulation, speculation, particularly in fields not covered by price controls, such as securities and real estate, are thus fostered. These are the customary symptoms of an inflationary spiral, which can end only in collapse and deflation. When that stage is reached, diminished incomes cause a sharp decline in Government revenues, leading to an unbalanced budget and a deficit which has to be financed chiefly by creation of more bank credit.

It is this chain of causation that has to be prevented, first of all, by full and sustained production and, second, by having the Government discontinue its creation of bank credit and reduce as rapidly as possible its debt. Even under the most favorable auspices, of maintaining high levels of taxation and of careful economy, the process of reducing the redundant money supply will be slow and gradual. It may be offset, not only by creation of bank credit to finance necessary private production, but by creation of bank credit that finances speculation in existing assets, whether commodities, real estate, securities, or Government bonds.

The creation of unnecessary bank credit by the commercial banking system is the particular concern of those charged with monetary responsibilities. It can not be a matter of indifference that at present the country's central banking mechanism lacks appropriate means, that may be needed, to restrain unnecessary creation of bank credit through continued acquisition of Government or other securities by the commercial banks. So long as the Government is able, whether out of its surplus cash balance as at present, or out of a future budgetary surplus, to pay off its debt held by the commercial banking system, a restraining influence is exerted.

Nevertheless this restraint may not suffice because of circumstances which are the heritage of war financing. One of these is the Reserve Board's assurance to the Treasury that the rate of 7/8 per cent on one-year certificates will be maintained, if necessary, through open market operations. This means in practice that the Federal Reserve stands ready to purchase short-term Government securities in the open market in order to prevent short-term interest rates from rising above the level the Government is now paying. This assurance is necessary from the standpoint of the Government's financing operations, and was given because the Board does not favor a higher level of interest rates than the Government is now paying.

This policy makes it possible, however, in the absence of effective restraints, for commercial banks to sell short-term, lower-yield Government securities to the Reserve System and thus acquire reserves which, on the present basis of reserve requirements, can support a sixfold expansion of member bank credit. To the extent that commercial banks use these reserves, either for their own account or in loans to customers, for the purpose of purchasing longer-term, higher-yield Government bonds or other securities, the money supply can thereby be increased on the volition of the banks irrespective of national monetary policy and without control such as exists in other principal countries.

There remain outside of the banks approximately 20 billion dollars of Treasury bonds which are eligible for bank purchase. An additional 34 billion, now ineligible for banks to purchase, will become eligible during the next 15 years. Thus, even though the Federal budget is balanced and Government debt continues to be paid down, there will be some 55 billion dollars of Treasury bonds that could be acquired by the commercial banks, in the absence of effective restraint. Commercial banks hold some 20 billion dollars of certificates and, at least theoretically, could by selling less than half of these certificates to the Reserve System obtain enough reserves, on a six-to-one ratio, to absorb all of this 55 billion dollars of Government bonds. This is wholly aside from what other loans and investments banks could make on the basis of the potential reserves available.

It is this possible further monetization of the public debt which may need to be subjected to more definite restraint, if monetary policy is to be effective and, indeed, if the commercial banks themselves are not to induce a further lowering of the interest rate structure. This in turn would reduce the earnings of banks from sources other than their Government bond portfolios. Furthermore, such continued, uncontrolled monetization of the debt and the consequent decline in interest rates would further accentuate speculative inflationary forces in all capital assets. Constant downward pressure on interest rates arising not from the accumulation of savings but from the creation of unnecessary bank credit is not desirable under inflationary conditions.

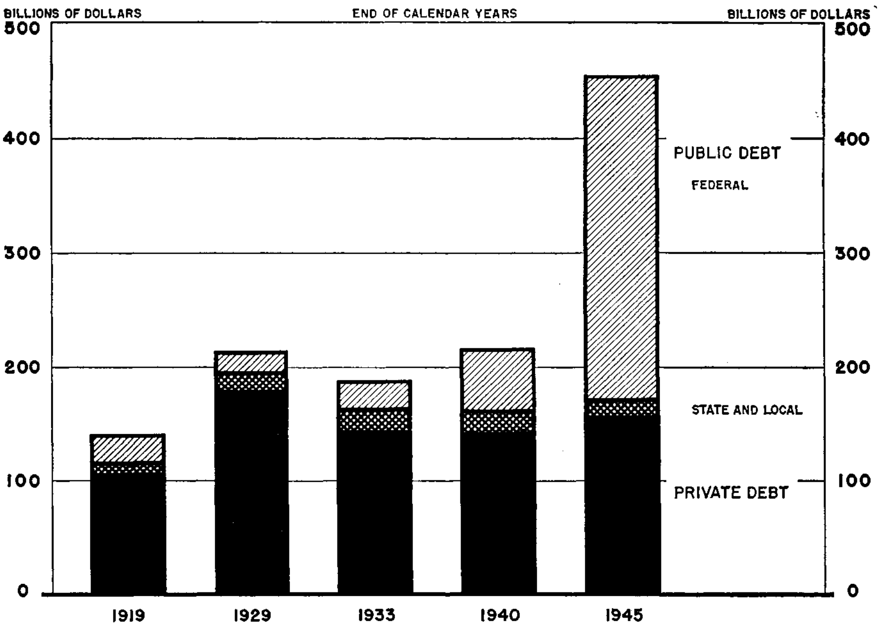
Excessive competition for and the consequent bidding up of market prices of outstanding longer-term Government securities makes for private speculative profits but not for a saving to the Government. Continued declines in the rate structure bear most adversely upon the many millions of the country's savers, upon insurance companies, savings banks, endowments, trust funds, and pensions, Instead of a further monetization of the debt by the commercial banking system, public policy at this time would be well served if the banks were to sell some of their longer-term holdings to nonbank investors and if bank holdings of the debt were more concentrated in short-term securities which bear low rates of interest. Bank earnings in general reached a higher level in 1945 than at any previous time as a result of profits and earnings from Government securities. While the peak of receipts from this source has probably been reached, it would be preferable if bank earnings were derived increasingly from private lending and other operations in response to necessary community requirements, and if less reliance were placed upon earnings from Government securities.

There can be no assurance that the process of shifting from the shorter- to the longer-term Government securities will be discontinued unless the shorter-term rates should rise to the point where the shifting would no longer be profitable—and this would be undesirable because it would increase the cost to the Government of carrying the public debt. Unless some adequate restraint could be exercised as to the amount and kind of Government securities that commercial banks may hold in relation to their demand deposits, the issuance of additional long-term securities to the market could result in a continued monetization of the debt, even though the securities were made ineligible for bank purchase. For there would be nothing to prevent the sale of existing eligible securities to the banks and the use of the proceeds to purchase the new issues. Even though the funds thus obtained by the Government were used to pay off short-term maturing debt held largely by the banks, there would be nothing to prevent the banks from replacing, through market purchases, enough of the eligible securities to equal the amount paid off. Under such circumstances, nothing would be gained towards reducing the money supply.

If the Federal debt occupied the relatively subordinate place in the economy that it held even up to 1940, the problems of debt management would be far simpler and the question of increasing the cost of carrying the debt would manifestly be of less significance. However, the Federal public debt at the end of 1945 had reached 280 billion dollars, or nearly six times what it was five years before. Whereas it was equal to about one-fourth of the entire debt of the country in 1940, by the end of 1945 it was nearly two-thirds, as is shown on the chart on page 6. Interest on the Federal public debt amounted to less than a billion dollars for the fiscal year 1939. It rose to 3.6 billion dollars for the fiscal year 1945, and according to budget estimates it will be 4.8 billion for the fiscal year 1946 and 5 billion for the fiscal year 1947. As a result of this fivefold increase, it has become the largest single item in the budget aside from expenditures for national defense, and exceeds by 800 million dollars estimated expenditures for veterans' pensions and benefits for the fiscal year 1947. In view of the large amount of short-term debt that will need to be refunded in the next few years, each full percentage point of increase in the level of interest rates would add up to a billion dollars a year to the nation's tax bill.

Proposals, therefore, for increasing interest rates, as an anti-inflationary influence, raise more formidable questions affecting the Federal budget, the levels of taxation, and the amounts paid on the debt to the banking system than was the case only a few years ago. In all principal nations the trend of rates paid by the Government has been downward rather than upward, notwithstanding the presence of comparable, war-created inflationary pressures. In other countries, Governments have been better able to exercise effective control over the amounts of Government securities purchased by banks and over the rates paid to banks for this financing.

TOTAL PUBLIC AND PRIVATE DEBT



Such comparisons would perhaps be unwarranted were it not for the fact that proposals have been publicly put forth in the United States suggesting that further debt monetization might be prevented through voluntary agreements on the part of the commercial banks of this country such as are entered into in some other countries. Such a solution for the problem would be far preferable to statutory regulations if it offered a reasonably assured prospect of success. The differences between the situation in the United States and in other countries arise because there are more than 14,000 commercial banks in the United States, operating under highly competitive conditions, and with three Federal and forty-eight State bank supervisory agencies. In England and Canada, the countries usually cited in connection with voluntary agreements, competitive and other conditions are entirely dissimilar. Each of these countries has but one bank supervisory authority. There are but ten chartered banks in Canada, while in England about a dozen banks do most of the banking business. It is a relatively simple matter to bring about voluntary agreements among so few banks and to obtain equitable observance, but in view of the different situation prevailing in the United States it would be impossible to enter into or to enforce similar agreements.

Another proposal, which has been more frequently advocated, is that the Reserve System discontinue its policy of maintaining the ⅞ per cent rate on Treasury certificates, and that open market operations be directed only towards maintaining the rate of 2½ per cent on the longest term bonds. This suggestion contemplates that the short-term rate would rise to a point close enough to the long-term rate to discourage commercial banks from selling short-term securities to the Reserve System and purchasing the long-term securities in the market. It is contended that an increase in the short-term rate from ⅞ to as high as 1¼ per cent would increase the cost of carrying the public debt by an estimated 200 million dollars and that this would be a small price to pay in combating inflationary dangers. However, there is no assurance that this much of an increase in the short-term rate would stop further debt monetization and even less reason to suppose that it would be of value in combating inflationary dangers which have arisen from two primary causes, neither of which would be corrected by higher rates. One cause is the volume of money already created, which can not be rapidly reduced. The other, and by far the most important basic cause, is the insufficiency of production as yet in relation to the existing money supply.

A major consequence in attempting to deal with the problem of debt monetization by increasing the general level of interest rates would be a fall in the market values of outstanding Government securities. These price declines would create difficult market problems for the Treasury in refunding its maturing and called securities. If the price declines were sharp they could have highly unfavorable repercussions on the functioning of financial institutions and if carried far enough might even weaken public confidence in such institutions.

The Board, therefore, does not believe that the problem could be met by voluntary agreement among 14,000 commercial banks or that it could be dealt with effectively by increased interest rates unless they were so high as to be a deterrent to necessary production, apart from the serious consequences to the Government security market.

If traditional interest rate policy or voluntary agreements are not appropriate or feasible, then what alternatives remain for preventing further debt monetization? Various alternatives have been suggested, some of which the Board considers too restrictive or otherwise impractical. Among the proposals which the Board believes worthy of consideration by the appropriate committees of the Congress are the measures outlined in general terms below.

One measure would be to empower the Board of Governors to place a maximum on the amounts of long-term marketable securities, both public and private, that any commercial bank may hold against its net demand deposits. This measure would serve to restrict the banks' demands for long-term Government securities and to strengthen their demands for short-term securities. It would not restrict the banks' ability to make loans or to purchase long-term securities against savings deposits. It would reduce, however, the existing inducement to sell short-term securities to the Reserve System, thus creating additional reserves, in order to purchase higher-yielding, long-term issues. The voluntary agreement adopted in Canada is similar to this limitation, which would be consistent with good banking practice in this country.

Another measure would be to empower the Board of Governors to require all commercial banks to hold a specified percentage of Treasury bills and certificates as secondary reserves against their net demand deposits. To aid banks in meeting this requirement, they should be permitted to hold vault cash or excess reserves in lieu of Government securities. This measure would result in stability of interest yields on short-term Government securities and, therefore, of the cost of the public debt. Like the bond portfolio limitation, it would provide a measure for regulating commercial banks' demands for short-term Government securities relative to their demands for longer-term issues. At the same time, it would leave considerable freedom for movement of interest yields on non-Government paper of short-term maturity.

Some administrative flexibility should be authorized in connection with either of these measures in order to meet differences among banks as well as to adjust to the changing needs of the economy for bank credit expansion or contraction.

A further possibility would be to grant additional power to the Board to raise reserve requirements, within some specified limit, against net demand deposits. If this authority were granted, banks should be permitted to count vault cash as reserves, and there should be provision for greater administrative flexibility in applying changes in requirements. To assure effective control, all commercial banks should be subject to the same reserve requirements. Adoption of this measure would strengthen the capacity of the Federal Reserve to prevent bank credit expansion on the basis of additional reserves obtained through gold imports or return flows of currency from circulation.

Under present conditions, however, when banks have relatively small amounts of excess reserves, increases in reserve requirements would make it necessary for banks to liquidate some of their assets. This would result in a rise in interest rates or necessitate Federal Reserve purchase of sufficient securities to provide the additional reserves. Under a continued policy of maintaining the existing level of short-term interest rates, the principal effect of an increase in reserve requirements would be a shift of Government securities from the commercial banks to the Reserve Banks.

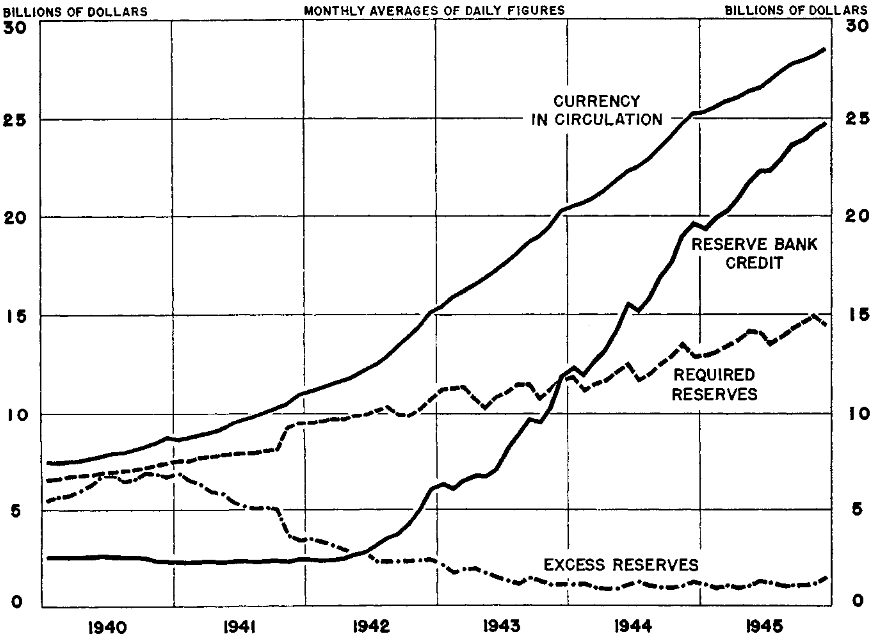
Each of the foregoing measures would provide additional instruments for coping with emerging banking and monetary problems without increasing the cost of Government financing or upsetting the market for Government securities. The suggested measures would help to strengthen the position of the banks and at the same time would enable them to continue their normal peacetime functioning in the financing of commerce, industry, and agriculture, as well as consumers.

WAR FINANCING POLICIES

When the United States entered the war in December of 1941, the Federal Reserve System announced that it was prepared to use its powers to assure that an ample supply of funds would be available at all times for financing the war effort and to exert its influence toward maintaining conditions in the United States Government security market that would be satisfactory from the standpoint of the Government's requirements.

As was stated in the President's budget message of January 14, 1946, "Close wartime cooperation between the Treasury Department and the Federal Reserve

RESERVE BANK CREDIT, REQUIRED AND EXCESS RESERVES OF MEMBER BANKS, AND CURRENCY



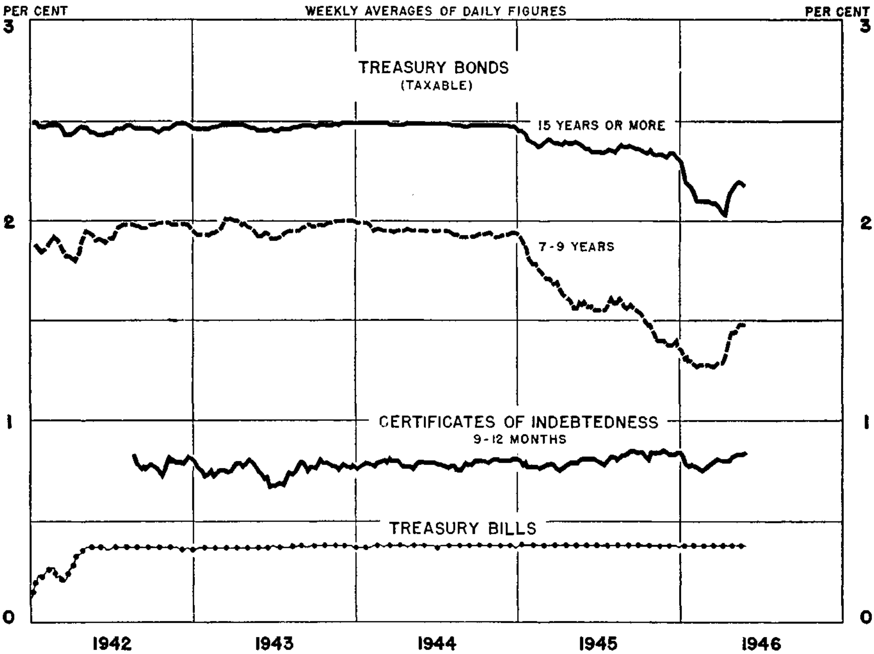
System has made it possible to finance the most expensive war in history at low and stable rates of interest." A structure of interest rates on Government securities conforming closely to the pattern prevailing at the beginning of the war was maintained. The rates on marketable securities ranged from 7/8 per cent on one-year Treasury certificates to 2½ per cent on the longest term Treasury bonds.

Federal Reserve purchases of securities provided the basis for the rapid growth of currency in circulation and also supplied the banks with additional reserves needed to support the expansion of bank credit and deposits. Under existing reserve requirements, each dollar of additional reserves permits an expansion of more than six dollars in bank credit and bank deposits by the banking system as a whole.

As is shown in the chart on page 9, Federal Reserve purchases of 22 billion dollars of Government securities, together with 7 billion of reserves in excess of requirements held by member banks in 1940, provided the basis for a wartime currency expansion of 20 billion and a growth of 8 billion in member bank required reserves. The increase in required reserves reflected an expansion of about 50 billion dollars in member bank deposits against which reserves are required; in addition there was an increase of over 20 billion in United States Government war loan deposits, which have been exempt from reserve requirements since early in the war period. There was also a large expansion in deposits of nonmember banks, which are not required to hold reserves with the Federal Reserve Banks.

As part of the System's policy, the Open Market Committee early in 1942 established a ⅜ per cent buying rate at which the Federal Reserve Banks pur-

YIELDS ON U. S. GOVERNMENT SECURITIES



chased all Treasury bills that were offered to them. There was also put into effect a provision by which banks could retain the option to repurchase Treasury bills from the Reserve Banks at the rate at which they had been sold. The banks were thus given assurance that they could at any time convert these short-term Government securities into cash and were, therefore, more willing to invest excess reserves in such securities. In the course of time, however, nearly all of these bills came to be held in the Federal Reserve portfolio, while commercial banks bought higher-yield issues.

A further step in encouraging the use of available banking funds to finance the war was the establishment at the Federal Reserve Banks, with the Board's approval, of a preferential rate of ½ per cent on advances to member banks secured by Government obligations with a maturity not exceeding one year. This enabled the banks to meet temporary needs for reserves by borrowing from the Reserve Banks rather than by liquidating their Government securities.

Establishment of low discount and buying rates on short-term securities was especially directed toward encouraging banks to purchase and hold short-term, low-yield issues rather than longer-term issues. This objective was also promoted through Treasury policy during the later years of the war of prohibiting or restricting bank holdings of certain longer-term issues offered in the war loan drives.

The effect of these policies in maintaining a low and stable structure of interest rates throughout the war period is shown by the chart on the preceding page. Maintenance of interest rates at low levels served several purposes: It encouraged investors to purchase securities without waiting for higher yields and to hold them without fear of loss from price fluctuations. It kept the market free from disorderly movements. It also retarded the growth in bank earnings on the securities they purchased. Finally, it held down the cost to the Treasury of interest charges on the greatly expanded public debt. As a result of these measures and policies, the Government experienced no difficulty at any time in raising the necessary funds. The average interest cost of the public debt to the Treasury was less than 2 per cent.

Bank credit expansion. While one of the objectives of war finance was to sell as many securities as possible to investors other than banks, some of the procedures followed in financing the war and in maintaining the structure of interest rates resulted in excessive bank credit expansion. In retrospect it is evident that more vigorous policies should have been adopted in order to raise more of the cost of the war through taxation and to restrict bank purchases of Government securities. If fewer securities which were eligible for bank purchase either at the time of issue or later had been offered, the wartime expansion of bank credit would not have been as excessive and the postwar problem of preventing further monetization of the debt might have been avoided.

Although war loan drives were directed toward nonbank investors, and banks were not permitted to subscribe for securities offered in the last six of the war loans except to a limited extent, the methods of conducting the drives resulted in large increases in bank holdings of Government securities. Individuals and businesses paid for securities in part by drawing on their existing deposits and in part by selling to banks securities bought in previous drives. Banks had reserve funds available during the drives because funds were shifted from deposits against which reserves are required to war loan accounts, which were exempt from reserve requirements. As a consequence a stimulus to expansion in bank credit was given during each war loan drive.

Between drives, as the Treasury drew on its accumulated balances to meet its current deficit, deposits of businesses and individuals increased. Member banks met the resulting increase in reserve requirements by selling securities to the Reserve Banks, thus creating new reserves. This process led to a gradual growth in bank reserves during and between drives on the basis of which member bank deposits expanded by more than six times the reserve increase. The Reserve Banks purchased whatever amounts of Government securities were necessary to supply banks with reserves to cover increasing requirements, as well as to meet the steady growth in demand for currency by the public.

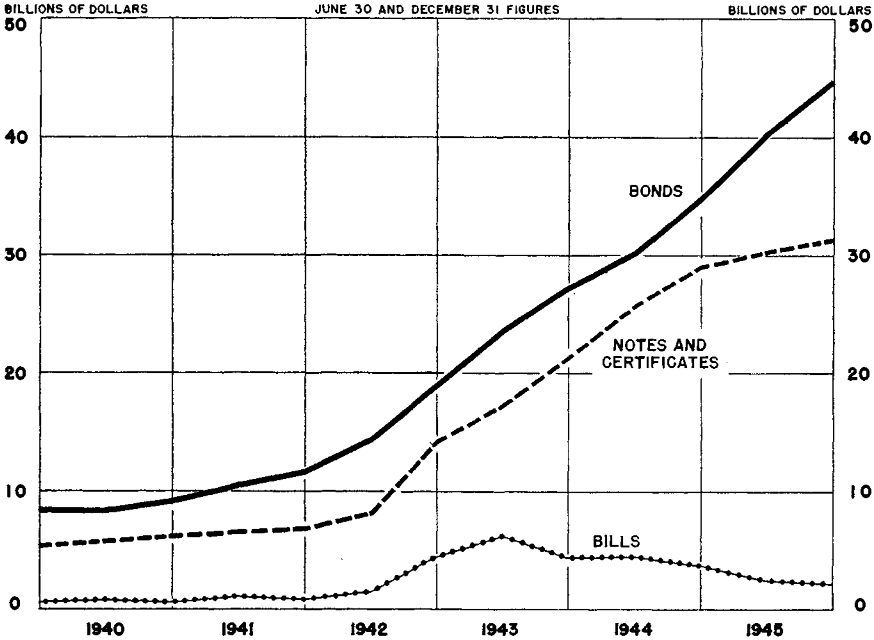
Another factor conducive to bank credit expansion during the war was the maintenance of the wide differential between short-term and long-term interest rates. This differential became established in the prewar period when, partly as a result of tremendous gold imports, banks and others had large amounts of idle funds seeking temporary investment and there was a limited supply of short-term investments. During the war, however, there developed a growing demand for long-term securities with their higher rates. Banks, as well as other investors, began to shift from short-term securities to the longer-term issues. The shorter-term yields were prevented from rising by Federal Reserve support to the market, and as a consequence longer-term rates tended to decline.

It has been especially profitable for banks and other investors to shift from short-term to the longer-term securities without reducing their potential liquidity, as long as the structure of yields on all Government securities continued to be maintained. Because of the lower rates maintained on short-term securities, outstanding longer-term issues rise in price as they approach maturity. Holders can sell these issues at a premium and then purchase other long-term issues yielding the same or higher returns. In many cases short or medium-term securities bought in war loan drives were sold during subsequent drives at a premium, while the holders purchased new issues at par.

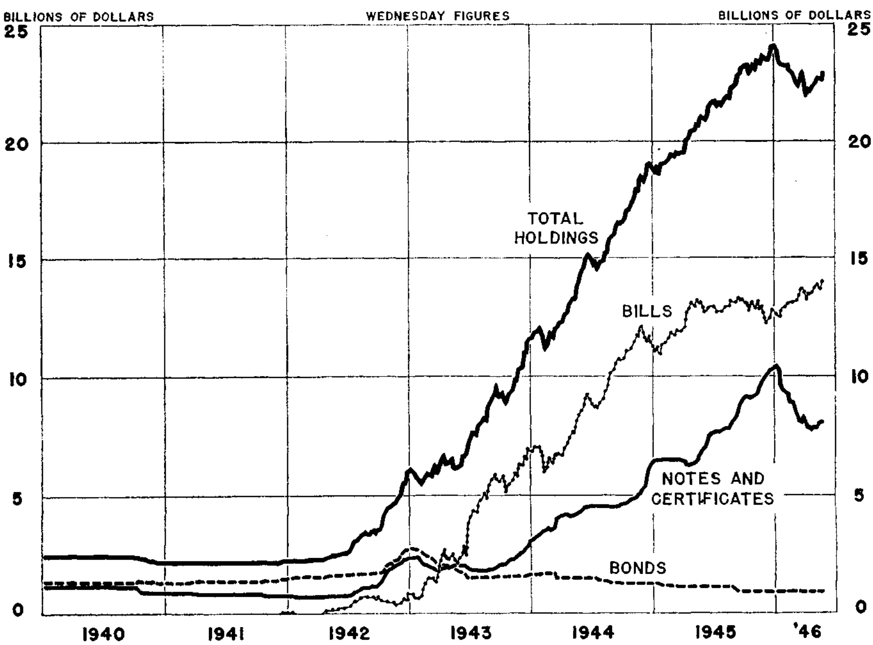
This practice, known as "playing the pattern of rates," brought about the decline in long-term interest rates, which increased the premiums on outstanding medium and longer-term issues. This practice led to bank credit expansion because Federal Reserve purchases created additional bank reserves on the basis of which the banking system as a whole was able to expand loans and securities by more than six times the amount of new reserves created.

Shifting by banks from short-term to longer-term securities occurred to an increasing extent after the middle of 1944. The first chart on the following page shows that in early years of the war the increases in member bank holdings of short-term bills, certificates, and notes were relatively greater than the growth in bonds. Since 1944, however, holdings of bonds have increased more rapidly than those of notes and certificates and bank holdings of bills have been substantially reduced. During the same period the Federal Reserve, as the second chart illustrates, rapidly increased its holdings of Treasury bills and more recently of certificates, while its small holdings of bonds were reduced.

MEMBER BANK HOLDINGS OF U. S. GOVERNMENT SECURITIES
BY CLASSES OF SECURITIES



FEDERAL RESERVE BANK HOLDINGS OF U. S. GOVERNMENT SECURITIES
BY CLASSES OF SECURITIES



Postwar financing policies. With the rapid decline in Government expenditures following the end of hostilities, the monetary situation has undergone a radical change. No further increase in the public debt is expected. There is, consequently, no need for the Treasury to sell additional securities to the banks.

Some of the forces that contributed to credit expansion and the consequent decline in long-term interest rates during the war no longer exist or are less influential. The absence of new borrowing needs by the Treasury is one of these. Another is the discontinuance of war loan drives with their special inducements to bank credit expansion. Utilization by the Treasury of its large cash balance to retire debt is resulting in a reversal of wartime tendencies. Bank holdings of Government securities are contracting, and retirement of Federal Reserve holdings tends to reduce bank reserves. Discontinuance of the preferential discount rate on advances secured by short-term Government securities by the Federal Reserve Banks discourages borrowings by member banks to hold Government securities or to make loans on such securities.

Continued retirement of Government securities held by banks would further decrease the volume of bank credit and bank deposits. The use of existing Treasury balances in banks to retire debt, however, does nothing to reduce the existing volume of deposits of businesses and individuals. To bring about a reduction in these deposits, it will be necessary for the Treasury to retire debt out of a budgetary surplus or to refund maturing securities now held by banks through the sale of new issues to nonbank investors.

In adopting a refunding program designed to reduce bank holdings of Government securities some departure from past practices would be necessary. As previously pointed out, banks hold a large volume of short-term securities, some of which can be retired as they come due, but there is also a large volume of outstanding securities available for purchase by banks. Any refunding program should endeavor to reduce the available supply of bank eligible issues not only at present but also for the future.

New issues should be of the type—such as savings bonds—that are nonmarketable and are redeemable upon notice on a basis that would give a proportionately lower return if redeemed before maturity. They would assure eligible investors of an opportunity for investment of savings funds. Under conditions calling for a budgetary balance or surplus the proceeds should be used to retire maturing public debt largely held by the banking system.. The rate should reflect the supply of savings funds relative to the demand and should not be a reflection of surplus funds created through unnecessary monetization of the public debt by the banking system. The investor would be guaranteed against risk of price fluctuations in case liquidation before maturity were necessary, but would receive a smaller yield for earlier redemption. Under present market conditions in which the short-term rate is supported, investors not only receive maximum yields on marketable long-term issues, which are in effect demand obligations, but they may also obtain a premium by selling their holdings before maturity. This premium varies according to the length of time that such issues are held.

Increased offerings of securities to nonbank investors would need to be accompanied by more effective restraints on bank credit expansion in order to prevent widespread sale to banks of securities eligible for bank purchase by holders wishing to subscribe for the new issues. If this were permitted offerings of these securities by the Treasury might stimulate rather than reduce further expansion in bank credit.

It is because of the monetary situation resulting from the war, as described in this report, and because of the probability that continued restraints will be needed that the Board recommends for consideration by the Congress the provision of additional powers which could be used to prevent further unnecessary expansion of bank credit without raising the cost of Treasury financing.

CONTINUED INFLATIONARY PRESSURES DURING RECONVERSION

Throughout 1945, after as well as before the end of fighting in Germany and Japan, shortages of goods and services to meet civilian demands were widespread and upward pressures on prices continued. Advances in commodity prices were generally held within rather narrow limits but only through direct controls, subsidy payments, and diversion of substantial amounts of income from markets for goods into taxes and savings. Increases in transportation costs, residential rents, and various service charges also were avoided in large measure, but here again price stability depended to a considerable degree on continuation of various direct and indirect controls. Capital values, which were not subject to direct control, rose considerably, with marked increases evident in prices of urban and farm real estate and also in security prices. Basic rates of pay were held close to previous levels for the most part but toward the end of the year substantial upward adjustments were being made in a number of industries, adjustments sought partly to offset decreases in earnings resulting from reductions in the amount of overtime work at premium rates of pay. Markets were generally strong in the latter part of the year, following a brief period of hesitation in August and September, when there was considerable uncertainty concerning the extent to which Government orders, then being canceled in tremendous volume, would be replaced by private buying.

During the period of hesitation numerous steps were taken to facilitate the transition and to prevent any greater amount of unemployment than would be unavoidable in a period of rapid demobilization and general liquidation of the war production program. Rationing, allocation, and inventory controls were discontinued in most lines, employment and wage controls were generally suspended or greatly modified, and Federal taxes were revised downward. Taxes on business were reduced, chiefly through elimination of the excess profits levy, and taxes on individual incomes were lowered, all effective at the beginning of 1946. To facilitate the financing of reconversion, provision was made for prompt deduction from current tax obligations of part of the refunds due to business enterprises under wartime tax laws. Action was also taken to expedite the settlement of war contracts. Direct price controls, however, were continued in order to prevent inflationary developments during an interim period before supplies could be expected to be available in sufficient quantity to stop any general sharp price rise.

Shortages at the end of the year. Shortages in this country, it is true, were not at any time comparable with those in war-devastated areas abroad, and, moreover, soon after the war ended some commodities like gasoline, which had not been freely available during the war, came to be in ample supply. Shortages were sufficiently widespread, nevertheless, to endanger price stability and orderly reconversion. Consumers, producers, and distributors in this country and foreign buyers as well found it impossible to obtain many of the things they were seeking. There were not enough houses to meet heavy consumer demands and not enough commercial structures to meet business demands. Existing stocks of passenger automobiles and many other durable goods held by consumers were considerably smaller than before the war and in some instances almost no new supplies became available before the end of the year. There were many shortages, some of which were not foreseen, of consumer nondurable goods such as clothing and food. Producers were still short of many materials, including imports such as tin and copra, and of numerous component parts required for the manufacture of finished products. In some lines of great importance to the war program much new plant and equipment had been installed during the war, but in others existing plant had deteriorated and replacement requirements were urgent; moreover, large expansion programs were being undertaken in industries with prospects for large sales in the period ahead.

The principal factors underlying the continued widespread shortages at the end of the year were: (1) the depletion of stocks of many goods in the hands of consumers, distributors, and producers resulting from lack of production for several years beginning in 1942; (2) the strengthening of the financial position of business enterprisers and consumers, who had been able to increase their holdings of liquid assets and to reduce their indebtedness because of the large excess of income over taxes and expenditures for goods and services; (3) the continued high, although somewhat reduced, level of income distributed after the war, primarily in connection with a growing volume of production for civilians but partly also, especially at first, in connection with the liquidation of the whole war program; (4) the disposition of consumers and producers to use funds at their disposal rather freely for a wide range of purposes; (5) the time required to transfer manpower and other resources from wartime activities to peacetime production—a start had been made in 1944 and again after the end of the war in Europe, especially in output of producers' equipment, but it was only a start; and (6) the additional time needed after the transfer of resources to turn out sufficient materials, and later finished products, to meet heavy accumulated and current demands. Disorganization of economic life abroad was a factor increasing the immediate demand for products of the United States and limiting the amount of materials available for importation into this country.

Speculative withholding of goods from the market was not a major factor in shortages during 1945, although instances of such withholding were reported at the end of the year. In brief, shortages persisted because, even in an economy as flexible as that of the United States, deficiencies developed in several years of warfare could not be eliminated in a few months.

Increased production of civilian goods. In general, where physical reconversion of plant facilities was required it was accomplished quickly, and in many industries, especially those producing materials, the changeover involved little if any interruption in output. Producers did encounter continuing problems, however, in obtaining large and balanced supplies of materials and parts essential for full production. This was the result of the great shift in requirements and the great difficulty of expanding rapidly the output of such things as building materials, which in the later stages of the war had not been required in as large volume as some other goods. In some instances deliveries were delayed in disputes over ceiling prices. Recruiting of workers for industries paying relatively low wages, as, for example, certain textile and building material industries, proved to be a slow process.

Output, moreover, was interrupted in a number of lines by labor-management disputes, and such disputes became more numerous toward the end of the year. Issues relating to organization matters as well as to wage rates were involved in some disputes and a number of important work stoppages continued for considerable periods. The coal, petroleum refining, glass, lumber, and automobile industries were among the more important industries directly affected by work stoppages. In many industries, however, agreements were reached on new wage scales 10 per cent or more above previous levels without interruptions of output. Altogether from 5 to 6 million workers obtained increases in basic rates in this period. And in many leading industries, including steel, electrical equipment, meatpacking, and the railroads, negotiations did not reach a critical stage until after the end of the year. One of the broader issues involved throughout these negotiations was the extent to which higher wages could be paid without increasing prices, an issue which hinged in part on differences in view as to the prospective volume of business and the levels of productivity attainable.

Notwithstanding the numerous problems of readjustment, production in the economy as a whole declined less during the early autumn than had been expected by many observers and in the final months of the year increased. At factories and mines, where a large part of production for war purposes had been concentrated, the total volume of output declined from 235 per cent of the 1935-39 average in March and 210 in July to 162 in October, and then advanced to 168 in November. Elsewhere in the economy, activity generally increased, as in the construction industry and in many service industries, or showed little change, as in agriculture and on the railroads. The value of the total national product, as represented by expenditures for all currently produced goods and services, including the services rendered by the armed forces, declined only from an annual rate of 206 billion dollars in the second quarter of 1945 to about

185 billion in the fourth quarter. The decline in physical volume of all goods produced and services rendered was not much greater than this. It was thus in spite of a high level of production that shortages persisted in this period.

As compared with the 1935-39 average—not a wholly satisfactory standard in view of the low levels prevailing then—industrial production in the fourth quarter was up 65 per cent, and output of electric power for all purposes was up 80 per cent. In agriculture production for the year was about 30 per cent above the level for the prewar period. Construction activity was rising rapidly at the end of the year but was still not up to the prewar level.

In interpreting these figures for increases since 1935-39 in relation to potential levels in the years ahead, account should be taken not only of the low level of production before the war—an average of about 9 million persons were unemployed—but also of the increases which have occurred since then in the population and the labor force and the improvements which have been developed throughout the economy in techniques of production. Notwithstanding the higher levels of production prevailing at the end of 1945 than before the war, further substantial increases appear to be feasible. Moreover, it is evident that to an increasing degree productive activity will be reflected in increased output of finished products for consumers rather than, as was true to an unusual degree in the latter part of 1945, in production of materials and parts and of industrial equipment for producers.

High level of employment. One important element in the production and supply situation at the end of 1945 was that by that time over 5 million persons in excess of the number currently recruited had been mustered out of the armed forces, and more than this number had been released from employment in war production. This helped to make possible the rapid growth in production for civilians. Concern lest the release of so many workers from the war program in such a short time would lead to an exceptionally large volume of unemployment did not prove warranted. This was partly because withdrawals from the labor force were quite rapid, numbering 2 million or more in this period, and because veterans in many cases did not immediately begin looking for jobs. The principal factor, however, was the absorption of workers in employment for civilian purposes.

The total number of workers employed at the end of the year, excluding 7 million still in the armed forces, was over 51 million, and the number unemployed was about 2 million. The work week meanwhile had been reduced from peak wartime levels but continued to be longer than before the war. In manufacturing the average number of hours worked per week in December 1945 was about 10 per cent below the wartime maximum and 10 per cent above the 1939 average. Further reductions in hours as well as increases in production and employment may be expected during the early months of 1946 as releases from the armed forces proceed at a rate of about a million a month, more than offsetting withdrawals from the labor force and steadily increasing the number of workers available to increase production.

High incomes. Shortages continued after the end of the war partly because of the high level of income which encouraged buying both by business enterprises and by individuals. In the fourth quarter individual incomes, on a seasonally adjusted basis, were at a rate of 157 billion dollars a year, as compared with 163 billion in the second quarter and 67 billion in the 1935-39 period. Incomes in the boom year 1941 amounted to 93 billion dollars.

The reduction in income from the second quarter to the fourth quarter of 1945 reflected a sharp decline in factory pay rolls and some decline in payments to the armed forces, offset only in part by increases in other payments. Factory pay rolls declined about 30 per cent, as activity in many of the higher pay industries declined sharply and the amount of overtime work at premium rates of pay was reduced. There were, however, large increases in wage and salary payments in various other parts of the economy, where activity had been greatly restricted during the war. Unemployment compensation payments and discharge payments to veterans increased considerably. The net income of farmers continued at peak levels and that of other proprietors advanced further. Although corporate profits were somewhat below the high levels of previous wartime years, dividend payments were maintained.

At the end of the year many of these shifts in income payments were continuing, but pay rolls in manufacturing had already begun to increase as activity rose and as wage-rate increases became effective.

Strengthened financial positions. The holding of greatly increased liquid assets by businesses and individuals, discussed in a subsequent section of this report, was an important factor strengthening the demand for goods and services currently being produced and for capital assets and used goods as well. Increases in other reserves, such as insurance and pensions, and substantial reductions in private debt also tended to strengthen market demand.

The improvement in the financial position of business enterprises and individuals as compared with prewar years was not as great as figures on liquid asset accumulation, debt reduction, and the like would suggest, because meanwhile prices had advanced considerably. Moreover, not all people in the country had shared equally in the improvement which did occur. Nevertheless, in view of the general situation and the experience of the latter part of 1945, it appears evident that the improvement in financial position was a real factor in encouraging purchases of all sorts of things and bidding up of prices where shortages persisted and direct controls were not in effect.

Heavy business and consumer demands. Available information shows that expenditures other than those for war purposes generally increased from the second quarter to the fourth quarter of 1945, and it is apparent that outlays would have been made for many more goods and services at the end of the year as well as earlier if they had been available. As it was, consumer outlays increased from a rate of 100 billion dollars a year to 111 billion in this interval and there was a further expansion to 120 billion in the first quarter of 1946.

This rise reflected mainly the purchase of more goods and services, although there was a gradual rise in prices in this period.

As the armed forces were demobilized the size of the civilian population increased. As more goods became available there was increased buying from current income and, in many individual instances, from the disposition of existing assets. The rate of 111 billion dollars of consumer expenditures in the fourth quarter was not only a record in dollar terms but was also a real increase, in physical terms, over the level prevailing at the end of the war and in 1939. The level reached, however, was not as high as that in 1941, and changes from prewar levels varied greatly for different types of goods and services. This unevenness of change was partly a result of the unavailability of supplies of some things and partly a reflection of variations in demand for different products that result from rising incomes. In general demand was strong for most semi-durable goods like clothing and for perishable products, as well as for durable goods. But as yet there were few new durable goods available for purchase.

Business expenditures for new plant and equipment and for inventories, as well as for materials to be fabricated and immediately passed along to consumers, expanded considerably. Here again outlays were limited by lack of available supplies rather than by lack of funds or the disposition to use them.

Expenditures for construction of new houses increased considerably, with the limiting factor being supplies of building materials. The number of new dwelling units started in the fourth quarter was about 90,000 as compared with 60,000 in the second quarter, but the rate was still low relative to prewar levels and very low relative to the rate needed in the early postwar years. In the first quarter of 1946 the number of new dwelling units started rose further to approximately the previous highest level.

Advanced levels of prices. As a result of all these developments affecting the availability of supplies and the intensity of demand, upward pressures on prices were generally strong throughout 1945, except that for a brief period when hostilities ended there was weakness in some markets, particularly for certain agricultural products. Sharp price increases generally in 1945 were avoided only through the operation of various controls, direct and indirect.

While prices in wholesale and retail commodity markets showed only gradual increases during the year, prices for real property and for common stocks advanced sharply. Housing facilities were almost universally short of demand and active bidding drove values in urban areas up about 10 per cent further during the closing months of the year. The level reached at the end of the year was about 60 per cent above that of 1940 although meanwhile rents had not been permited to advance materially. Commercial properties, not subject to rent control, were also in great demand. Values of farm real estate, which had increased at a fairly rapid rate during the war under the stimulus of greatly increased farm income, showed less increase for a brief period after the end of the war but later the advance was accelerated. By the end of the year the increase over the prewar level amounted to nearly 70 per cent, which was about the increase shown from 1914 to 1920 in percentage, though not in dollar, terms. The advance in real estate prices generally provided an opportunity for speculative activity on a growing scale.

Prices of common stocks advanced about 20 per cent in the latter part of 1945 and the volume of trading was relatively large. The general level reached was close to the peak in the early part of 1937. Restrictions imposed on the use of credit for trading in securities are discussed in another section of this report.

The general situation concerning prices as the year closed was more evident in information dealing with the forces which lie back of prices than in price statistics. This was true partly because of the effectiveness of controls in preventing price increases and, in some instances, because of trading in black markets at prices much above the legal limits. Moreover, price statistics do not fully reflect shifts in buying from low-priced to high-priced goods that result in considerable part from a scarcity of low-priced items and do not reflect changes in demand that accompany increased incomes.

Price data, nevertheless, indicate that the increases during the war period were large, although not as great as those during the first world war, and that they were widespread, although by no means uniform. Wholesale commodity prices were up about 40 per cent from the 1939 level and 35 per cent from the average for the 1935-39 period. Farm product prices were double the 1939 level. At retail, prices of food and clothing were up fully 50 per cent. Rents had shown little rise, however, and the increase above January 1941 in the cost of living recognized for purposes of wage adjustments was 33 per cent. Marked advances in prices of real estate and of common stocks have been referred to in preceding paragraphs.

Altogether this is an impressive list of increases, and the underlying situation at the end of the year was such that further advances occurred in the early months of 1946. Adjustments in price relationships, as in production relationships, also were in prospect in the further transition to peacetime conditions. There was danger, however, unless direct and indirect controls were maintained in most instances and even increased in some cases, that price increases would not be limited to those necessary for the reallocation of resources but would become widespread and hamper rather than facilitate the orderly increase of production required to eliminate the extensive shortages still in evidence.

GROWTH IN LIQUID ASSETS

One of the most important wartime developments was a rapid growth in holdings of liquid assets, including currency, bank deposits, and United States Government securities. Between June 1940 and December 1945 personal and business holdings, excluding those of such groups as insurance companies, banks, and governmental bodies, more than tripled. The increase was nearly 155 billion dollars, of which a third was business holdings and two-thirds personal. There was a sevenfold expansion in holdings of United States Government securities by these groups, which accounted for half of the total increase in all types of liquid assets. The growth in demand deposits amounted to almost 38 billion dollars, while currency increased nearly 20 billion and time deposits 21 billion.

These rapid increases were a result of an excess of income, even after payment of wartime taxes, over the supply of goods available for purchase during the war. Throughout the period the proportion of resources devoted to war production remained considerably higher than the proportion of wartime incomes taken in taxes. The excess of income available after taxes over the income which could be spent on consumption goods at the prices prevailing was necessarily saved, and as relatively little private investment was taking place, most of the saving was in liquid form.

These large holdings of liquid assets in part represent more or less permanent saving which people are holding against old age or a rainy day; in part they represent larger working balances required by the growth of business and by wartime disturbances of normal expenditure patterns; and in part they represent deferred purchasing power likely to come on the market as soon as goods are available, particularly goods the production of which was curtailed or eliminated during the war. If even a small fraction of the total should be used in a short period of time to buy goods, the effect in stimulating price increases would be great. On the other hand, if most liquid assets should be held as savings and only used in emergencies, their growth might well make a sizable contribution to the regularization of expenditures and the stabilization of economic activity.

Although reduced following the end of the war, the growth in liquid assets in 1945 remained large. As is indicated in the table, it amounted to 32 billion dollars, compared with 39 billion in 1944, 40 billion in 1943, and 30 billion in 1942. At the beginning of the war business holdings expanded rapidly, but after 1943 the rate of increase slowed down as business experienced larger current tax payments and began to pay off bank loans and other indebtedness. In the second half of 1945 the start of reconversion intensified this development. Demand deposits held by businesses showed little change, while business holdings of liquid assets showed the smallest increase since early 1941. Demand deposits of manufacturing and mining concerns in fact declined by about 2 billion dollars, but balances of trade and service firms increased. An overwhelming portion of the increase in business liquid assets over the war period as a whole was accounted for by increased holdings of United States Government securities and demand deposits.

Individual holdings, on the other hand, increased most rapidly after 1942, and in the second half of 1945 the increase was at a more rapid rate than during any previous period except the second half of 1944. Government securities were the major form taken by personal holdings, but in the past three years there has also been a rapid increase in time deposits.

It is to be expected that the increase of such assets in 1946 will be considerably slower than it has been in the past. The sharp reduction in the Treasury's deficit almost removes the principal cause of the wartime expansion in liquid assets. Since the first of the year there has been a small decrease in currency in circulation and little further change in demand deposits, while time deposits have continued to expand. Treasury war loan accounts are being drawn upon to retire Government securities; since a large part of these securities are held by banks, the effect of such retirements on business and individual holdings of demand deposits and Government securities is relatively small.

Some shift in asset holdings from businesses to individuals may continue in 1946, as business as a whole uses its holdings to meet accrued tax liabilities and costs involved in establishing peacetime production. Some segments of business—

ESTIMATED LIQUID ASSET HOLDINGS OF INDIVIDUALS AND BUSINESSES[1]
[In billions of dollars]

	Outstanding Dec. 31, 1945	Increase June 30, 1940 to Dec. 31, 1945	Change during year				
			1945	1944	1943	1942	1941
Total	221.2	+153.5	+31.0	+39.0	+39.6	+30.4	+10.8
Currency	25.5	+19.4	+2.9	+4.6	+4.9	+4.2	+2.3
Demand deposits	60.3	+37.4	+7.2	+6.0	+10.4	+8.8	+3.5
Time deposits	47.7	+21.0	+8.7	+7.0	+4.3	+0.8	0
U. S. Government securities	87.7	+75.7	+12.2	+21.4	+20.0	+16.6	+5.0
Business holdings—total	73.4	+52.7	+5.2	+11.6	+17.4	+13.0	+3.9
Deposits and currency	42.1	+24.5	+3.0	+3.5	+9.1	+5.4	+1.7
U. S. Government securities	31.3	+28.2	+2.2	+8.1	+8.3	+7.6	+2.2
Personal holdings—total	147.8	+100.8	+25.8	+27.4	+22.2	+17.4	+6.9
Demand deposits and currency	46.8	+33.4	+7.5	+7.5	+6.4	+7.7	+4.1
Time deposits	44.6	+19.9	+8.3	+6.6	+4.1	+0.7	0
U. S. Government securities	56.4	+47.5	+10.0	+13.3	+11.7	+9.0	+2.8

[1] These estimates differ from the published totals for deposits, currency, and holdings of United States Government securities, which are the totals used in an earlier part of this report. The estimates are designed to cover what domestic individuals and businesses hold *according to their records*. In every case the estimated holdings of foreigners, the banking system, insurance companies, building and loan associations, nonprofit institutions, and governments or government agencies, corporations, and trust funds have been deducted. In the case of demand deposits an additional deduction has been made from holdings as reported by banks for the estimated amount of both bank and mail float. Further details of the methods used in making these estimates will be found in the Federal Reserve BULLETINS for June 1945 and February 1946.

particularly the trade and service groups—will probably continue to increase their holdings. It seems likely, however, that liquid asset holdings by individuals will increase in relative importance during the year.

CONSUMER CREDIT REGULATION

Throughout 1945 supplies of consumers' goods continued to be far short of demand, even though there was some increase in these supplies with the ending of the war and consumer demand was still subject to some restraint, including that imposed by the Board's consumer credit regulation, Regulation W. That regulation, a part of the Government's anti-inflation program, applies primarily to instalment credits for purchasing consumers' durable goods but applies also to consumer credits in other forms and for other purposes. Its typical terms require a down payment of one-third and limit the length of instalment contracts to 12 months. The only substantial changes, made about two months after V-J Day, were one which removed the control from credits for home repairs and home improvements and another which extended from 12 months to 18 the permissible maturity on consumer loans for purposes other than purchasing consumers' durable goods.

Regulation W went into effect about three months before Pearl Harbor at a time when the total volume of consumer credit was about 10.1 billion dollars. Reflecting in part the influence of Regulation W, but reflecting still more the curtailed production of consumers' durable goods such as are commonly purchased on credit, this amount decreased to about 4.9 billion in the early months of 1944. It then increased gradually to about 6.7 billion at the end of 1945. There was a further rise in the first quarter of 1946.

Consumers' goods of the kind which are typically purchased on credit—such as household appliances and automobiles—are beginning to become available again. As more of them come on the market, there is sure to be some further expansion of consumer credit, even under the terms presently prescribed by Regulation W. For a considerable time to come, however, expanding production of consumers' goods is likely to be short of demand arising from growing current incomes and from accumulated buying power. Under these circumstances any expansion of consumer credit will tend to aggravate a generally inflationary situation and, therefore, should be kept within moderate bounds. It is during the period while this danger remains acute that consumer credit regulation, like other anti-inflationary measures, is most essential. Unless powerful inflationary forces can be held in check during this period, they will generate the very situation in which powerful deflationary forces, well known to be even more difficult to hold in check, will begin to operate and be likely to gather momentum.

President Truman, referring to this subject in his Message to Congress dated January 14, 1946, made the following statement: "Continued control of consumer credit will help to reduce the pressure on prices of durable goods and will also prolong the period during which the backlog demand will be effective." Reference to the same subject has also been made by a congressional committee—the House Special Committee on Postwar Economic Policy and Planning—which said in a report dated September 8, 1944, "Some control of consumer credit, particularly of instalment credit, may be needed after the war," and in its later report dated March 4, 1946, that "continuance of control over consumer credit" is among the important fiscal and monetary measures which seem to the Committee to be desirable.

The Board recommends the consideration by Congress of legislation which will authorize and direct the Federal Reserve System to continue the regulation of consumer credit on a permanent basis and as an integral part of the System's function of maintaining sound credit conditions.

Over the past 30 years, consumer instalment financing has come to occupy an important and strategic place in the national economy. Such financing is essential to the mass distribution and consequently to the mass production of consumers' durable goods. From time to time, however, the expansion and subsequent contraction of consumer credit have gone so far as to accentuate the upswings and downswings of the business cycle. There is no way of preventing such excessive expansion and contraction except governmental regulation of the terms on which consumer credit shall be made available, such as the down payment required on instalment sales or financing and the length permissible for instalment contracts. To provide for such regulation, by legislation which will contemplate the timely tightening and timely easing of such terms, will assist the over-all program of stabilizing the national economy at a high level of production and employment. The Federal Reserve System, if directed by the Congress to perform this function, can bring to bear on its performance the experience of 30 years in formulating credit policy and the experience of the years since 1941 in administering consumer credit regulation, by Executive Order, during a period of national emergency.

MARGIN REQUIREMENTS

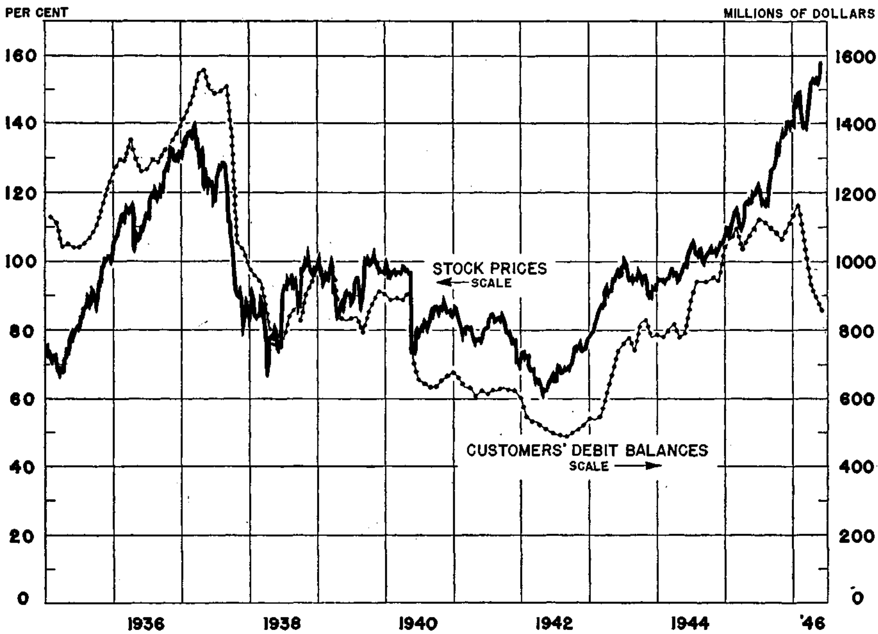
Growth in the supply of money, resulting from the war and its financing, continued during 1945 to exert strong upward pressure on the price levels of corporate securities. Prices of stocks advanced further during the year. There was, however, little increase in the amount of credit employed in purchasing and carrying securities. An important factor in restraining this increase in credit was action by the Board to raise margin requirements, first in February and again in July.

Stock prices declined during the early part of the war and in the spring of 1942 both the level of stock prices and the volume of stock market credit were at the lowest points in many years. Since then, the general movement of stock prices has been upwards, rising rapidly until the middle of 1943, again in the summer of 1944, and again at intervals in 1945. At such times, as is shown on the chart on the following page, the volume of stock market credit usually increased rapidly, reflecting increased buying of stocks on margin, which is well known to be largely speculative.

Increasing the margin requirements in February 1945 from 40 per cent to 50 per cent had little observable effect, either on the growth in stock market credit or on the course of stock prices, but it did operate to reduce somewhat the proportion of trading in stocks that consists of margin trading. After the requirements were raised in July to the 75 per cent level, however, the upward trend of stock market credit was reversed notwithstanding a further sharp increase in stock prices, the proportion of margin trading was further reduced, and margin traders sold more securities than they bought. This afforded evidence of the potency of margin requirements as an instrument of credit policy, the most impressive evidence in fact that has been afforded since the instrument was brought into use, by congressional mandate, in 1934.

A factor in this result was a rule first imposed in July which required the proceeds of all sales of securities in undermargined accounts to be used to reduce outstanding indebtedness in the account.

STOCK MARKET



Early in 1946, at a time when there was renewed governmental interest in combating inflation, when stock prices were rising rapidly and some increase was also taking place in stock market credit, the Board raised margin requirements to the 100 per cent level. In that connection, the Chairman of the Board issued a statement explaining the Board's action and at the same time calling attention to the need for more fundamental measures, particularly fiscal and monetary measures.

INTERNATIONAL TRADE AND FINANCE

End of the war in Europe and Asia marked a turning point in the trade and financial relations of the United States with the rest of the world. During the war period greatly increased exports of goods from the United States represented largely supplies financed under lend-lease agreements with anti-Axis countries. Commercial exports declined from the levels of 1939 and 1940, while imports increased. Various countries exporting to the United States to meet the heavy wartime demands found themselves restricted in purchasing from our limited supplies, and as a consequence accumulated large reserves of gold and dollar balances.

Following the end of the war lend-lease shipments were sharply curtailed while other exports increased sharply. This country again showed a substantial export balance on commercial account. While many countries of the world possessed adequate gold and dollar resources to make purchases here, those countries which had suffered most from the war and, therefore, had the greatest need for supplies, were not in a position to pay in cash for all the goods that were urgently needed. Arrangements were made to provide credits to meet some of these needs. The Export-Import Bank was reorganized, and its lending authority was enlarged primarily for the purpose of making reconstruction loans. An agreement was negotiated with the United Kingdom to cover the most pressing needs of that country for dollars during the next few years and the agreement was subsequently embodied in a bill which was introduced in Congress early in 1946. The Bretton Woods Agreements providing for an International Monetary Fund and an International Bank for Reconstruction and Development were adopted, and a National Advisory Council was set up to coordinate the lending activities of the United States Government and the policies and operations of the American representatives on the Bretton Woods institutions. The Chairman of the Board of Governors of the Federal Reserve System is one of the members of this five-man Council.

Foreign trade. Following the prompt curtailment of lend-lease shipments in September 1945, exports dropped sharply. October shipments, valued at 455 million dollars, were the smallest since the summer of 1941. There was a moderate recovery in the final two months of the year, when a sharp increase in private exports was supported by a substantial rise in UNRRA deliveries and by continuing lend-lease shipments which represented primarily the export of commodities for which repayment terms had been arranged. Total exports for the year (excluding shipments to our armed forces abroad) were valued at nearly 10 billion dollars, of which nearly 4 billion represented "commercial" shipments, i.e., shipments other than lend-lease and relief. The latter figure may be compared with 3 billion dollars of commercial exports in 1944 out of total exports of more than 14 billion. In view of the diverse movements of the three components of the export total during the year, the quarterly data shown in the accompanying table will present a more informative picture than

FOREIGN TRADE OF THE UNITED STATES

[In millions of dollars]

Period	Total exports				General imports
	Total	Lend-lease	Relief[1]	Other	
1941	5,147	739	....	4,408	3,345
1942	8,080	4,933	33	3,114	2,745
1943	12,964	10,357	59	2,548	3,382
1944	14,257	11,305	120	2,832	3,921
1945	9,806	5,561	485	3,760	4,136
Jan.–Mar.	2,820	2,047	48	725	1,024
Apr.–June	3,011	2,026	70	915	1,098
July–Sept.	2,145	1,111	118	916	1,050
Oct.–Dec.	1,830	377	249	1,204	964

[1] Including both public and private relief.

can be derived from annual figures. Imports were less affected than exports by the end of hostilities although the upward trend which had characterized the early months of the year was reversed in the autumn. Total imports of over 4 billion dollars were only slightly larger than those of 1944. In the last two months of the year commercial exports exceeded imports for the first time since November 1942.

Virtual discontinuance of lend-lease operations brought to a close the gigantic international supply program through which the United States shared its productive capacity with the anti-Axis forces of the world. From the inception of lend-lease in March 1941 to the end of September 1945, exports under the program exceeded 32 billion dollars and during 1943 and 1944 accounted for 80 per cent of total shipments from the United States excluding supplies furnished to our armed forces abroad. The great bulk of these exports went to the United Kingdom and the Soviet Union, which together received over 23 billion dollars worth of munitions, foodstuffs, industrial equipment, petroleum, and miscellaneous supplies. Africa and the Middle East received supplies valued at 3.5 billion dollars, over 2 billion of which were sent to Egypt largely for the use of the British forces. The Far East (principally India and Australia) received nearly 4 billion dollars of lend-lease supplies, European nations other than England and Russia approximately 1 billion, and Latin America approximately 365 million.

With the national energies concentrated on war, commercial exports were sharply curtailed. Meanwhile, merchandise imports rose somewhat above prewar values and were purchased predominantly for cash. For the four war years 1942-45 the United States had an import balance on cash account of approximately 1.9 billion dollars. This total figure conceals the considerably larger import balance of the United States in its cash trade with Latin America, the Near East, South Africa, and the Far East. The accompanying table shows the net balance of the United States in its commercial trade with various countries and

WARTIME TRADE OF THE UNITED STATES EXCLUDING LEND-LEASE AND RELIEF SHIPMENTS[1]

[In millions of dollars]

Area and country	1942–45			Last quarter 1945
	Exports	Imports	Balance	Balance
Canada	4,781	4,129	+653	+54
American Republics	3,600	5,513	−1,913	+13
Other Western Hemisphere	516	405	+111	+10
United Kingdom	1,119	413	+706	+81
U.S.S.R.	60	158	−98	−2
Other Europe	584	563	+21	+77
Near East and Africa	952	1,281	−329	+4
Western Asia	208	356	−148	......
British West Africa	46	96	−49	......
Union of South Africa	278	377	−100	......
Far East	641	1,721	−1,080	+3
India and Ceylon	263	739	−476	......
Australia	171	629	−458	......
Total	12,254	14,183	−1,929	+240

[1] Distribution of relief shipments, public and private, partly estimated.

areas of the world for the period 1942-45. The final column shows the shift in this balance during the final quarter of 1945, a shift for which both the decline of lend-lease shipments and the growth of commercial exports were responsible.

The cash merchandise deficit of the United States during the period was augmented by excess payments for service items of which the largest was military expenditure abroad. After allowing for services given and received under lend-lease and reciprocal aid, net service payments for the period probably totaled about 3.3 billion dollars. Because of the predominant importance of military expenditures in these transactions, it may be assumed that the bulk of the net payments went to those countries in which United States soldiers were stationed in large numbers. Payments on all current transactions, including both goods and services, thus exceeded receipts by over 5 billion dollars during these four war years.

Wartime expansion in holdings of gold and dollar balances. This excess of payments over receipts in the wartime accounts of the United States enabled foreign nations to purchase substantial amounts of gold from this country and, in addition, to build up their dollar balances. Net sales of gold by the United States Treasury amounted to 2.7 billion dollars over the period while foreign holdings of dollar balances increased by about 3 billion. Purchases of gold, together with wartime gold production, accounted for a rise in foreign gold holdings from nearly 10 billion dollars in December 1941 to nearly 16 billion in December 1945. Foreign holdings of dollar balances at the end of 1945 totaled 6.4 billion, of which 3.7 billion represented holdings of central banks and governments.

The increase in foreign dollar balances plus net sales of Treasury gold between the end of 1941 and the end of 1945 amounted to about 5.7 billion dollars, whereas excess payments on current transactions were estimated at 5.2 billion. The difference is largely accounted for by credit transactions other than those connected with the distribution of Army-Navy supplies for relief in foreign countries or with the sale of surplus property not entered in United States export statistics.

Of the total estimated increase of 9 billion dollars in foreign-held reserves of gold and dollar balances during the period 1942-45, nearly 6 billion is believed to represent additional holdings of gold. When estimated world production of 3.9 billion dollars is added to the figure for United States Treasury gold sales of 2.7 billion, the increase in world reserves is more than equaled. The 600 million dollars worth of gold remaining may have been absorbed in industry and in private holdings which were augmented by public sale of gold as an anti-inflationary measure in certain Eastern countries.

Of the 9 billion dollars added to foreign reserves since the end of 1941 over 2.5 billion went to Latin American countries of which about 2 billion was in payment for cash sales of goods and services to the United States. Perhaps an additional quarter of a billion dollars in gold was added to reserves from domestic gold production. The balance of the increase must be attributed to dollar sales to countries other than the United States. Canada, South Africa, and European neutrals added almost 3.5 billion dollars to their reserves, bringing the total for countries outside the theatre of hostilities to 6 billion. The major additions to reserves of countries which suffered war damage were the 1.4 billion dollar increase in "net" gold and United States dollar reserves between December 31, 1941 and the end of June 1945 reported by the United Kingdom and attributable largely to American military expenditures in the British sphere; and the increase of some 600 million dollars in China's reserves as a result of a United States loan of 500 million and of military expenditures in the country. The remaining billion dollar increase in reserves outside of the Western Hemisphere represents the sum of numerous small accretions to the reserves of various nations and includes an allowance for a sizable growth in Russian gold reserves resulting from domestic production.

Extension of credits to other countries. With the sharp reduction in lend-lease exports and military expenditures abroad in 1945 other methods of financing exports to foreign countries which had suffered from the war became necessary. During 1945 the United States lent on balance approximately 2 billion dollars to foreign countries. These loans represent for the most part special credit transactions in the second half-year in connection with the furnishing of supplies to civilian populations by the armed forces and the taking over by foreign governments of lend-lease inventories and surplus property.

In order to help finance some of the most essential needs of foreign countries the lending authority of the Export-Import Bank was increased from 700 million to 3,500 million dollars by an Act of Congress approved on July 31, 1945. During the last six months of 1945 the Bank authorized loans of roughly one billion dollars, most of which represented reconstruction loans to devastated countries of Europe. At the end of the year the Export-Import Bank had unused lending authority of 1,800 million dollars. The Bank's loans did not finance a large volume of purchases in 1945. Disbursements under all Export-Import Bank loans totaled only 59 million dollars during the last six months of 1945.

Export-Import Bank loans will play a major role in financing foreign needs in 1946 and in the early months of 1947. Thereafter the International Bank for Reconstruction and Development, which should reach full-scale activity in 1947, will be the main source of long-term foreign loans.

In December 1945 the governments of the United States and United Kingdom concluded discussions on trade and financial matters and announced agreements containing far-reaching proposals. The financial agreement proposes a loan of 3,750 million dollars by the United States to the United Kingdom to meet her unique balance of payments difficulties in the transition period. The agreements were approved by the British Parliament before the end of 1945 and submitted to Congress in 1946. Only with the help of the proposed loan is there any possibility that the United Kingdom will be able to meet the urgent needs of her economy in the transition period and at the same time eliminate exchange restrictions and discriminatory currency practices within the great sterling area.

Establishment of international financial organizations. Both the International Monetary Fund and the International Bank for Reconstruction and Development, proposals for which had been formulated at Bretton Woods in July 1944, came into existence at the end of 1945. The Bretton Woods Agreements Act authorizing United States membership was passed in July, and by the end of December the proposals had been accepted by the majority of the governments represented at Bretton Woods.

The total capital of the International Bank is 7,670 million dollars, of which one-fifth may be used by the Bank to make loans. The remainder can be called only if needed to meet obligations of the Bank. Total loans and guarantees of the Bank are limited to the amount of its unimpaired capital, surplus, and reserves. For the most part the Bank will either lend funds borrowed in member countries or guarantee the loans of private investors. The principal market for securities issued or guaranteed by the Bank is likely to be in the United States.

The International Monetary Fund aims to promote exchange stability, provide for orderly changes in exchange rates when necessary, and to eliminate harmful restrictions on payments for current international transactions. The Fund has 7,397.5 million dollars in gold and various currencies subscribed by members, which will be used to help them meet temporary deficits without resorting to harmful measures. The Fund will play an important role in the transition period in establishing a reasonable pattern of initial exchange rates and in working toward the elimination of wartime exchange controls.

The Bretton Woods Agreements Act provided for an important change in the assets of the United States Stabilization Fund established under the Gold Reserve Act of 1934. Of the Fund's total assets of slightly over 2 billion dollars, 1.8 billion will be used to pay part of the United States subscription to the International Monetary Fund. The remainder, which represents the portion of the United States Fund which has in the past been in active use, will suffice to carry on such operations as are necessary to supplement those of the International Monetary Fund.

The Bretton Woods Agreements Act also established the National Advisory Council on International Monetary and Financial Problems to coordinate the policies and operations of the United States representatives on the Fund and the Bank and of all agencies of the Government engaging in foreign financial transactions including the Export-Import Bank. The Council consists of the Secretary of the Treasury, the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Board of Trustees of the Export-Import Bank. The Council played an important role in coordinating the financial and lending policies of the United States in the second half of 1945.

V LOAN PROGRAM

During the year 1945 the Federal Reserve Banks, under the general supervision of the Board of Governors, continued to act as agents of the War Department, Navy Department, and United States Maritime Commission in guaranteeing war production and termination loans. Through this system of guarantees, made under Regulation V of the Board of Governors, 10.3 billion dollars in private production credits were made available to the nation's war industries, large and small, in 3½ years' time. The guarantee consisted of an agreement, made in advance of each loan, by which the procurement agency that required the particular production obligated itself to take over a specified portion of the credit risk at any future time, on demand of the bank or other commercial lending institution that had made the loan with its own funds. For this protection against possible loss, the lending institution paid a small portion of its interest return as a guarantee fee.

From the beginning of the V loan program in April 1942 to December 31, 1945, the Federal Reserve Banks received 9,605 applications for guaranteed loans aggregating 10.7 billion dollars. The War Department, Navy Department, and Maritime Commission authorized 8,757 guaranteed loans totaling 10.3 billion. Of these authorizations 6,678 for 8 billion dollars were War Department guarantees; 1,794 for 2.2 billion were Navy Department guarantees; and 285 for 174 million were Maritime Commission guarantees. Only 847 applications aggregating 335 million dollars were rejected by the guaranteeing agencies. The principal reasons for rejections were that the guarantor could not certify that the production of the applicant was necessary, appropriate, or convenient for the prosecution of the war, or that it was believed preferable to provide the necessary financing by advance payments. Of the 8,757 guarantees authorized, 7,999 were actually executed, covering credits aggregating 9.9 billion dollars.

When 1945 began, the volume of V loans was practically at its peak, with 6.2 billion dollars of credit available under agreements in force and 1.7 billion in guaranteed loans actually outstanding. The peak had been reached during 1944, when outstanding loans amounted to 2.1 billion on July 31 and total credit available to 6.3 billion on October 31. Following conclusion of the European phase of the war in May 1945 there was a slight reduction in the volume of guaranteed credits to 5.1 billion dollars in credit available and 1.4 billion in outstanding loans on June 30, 1945. After the surrender of Japan in August the decline in new loan applications, the termination of war contracts and subcontracts, the advances made by the procurement agencies prior to final settlement, and the rapid rate of such settlements greatly reduced the scope of the V loan operation. Only 1.5 billion dollars in aggregate credit available and 511 million in outstanding loans remained in force on December 31, 1945, although 1,323 new guaranteed loans amounting to one billion dollars had been arranged by the Federal Reserve System and authorized by the three procurement agencies during 1945.

Of these new guarantees 599, covering credit authorization of 264 million dollars, were for "T" loans authorized under the Contract Settlement Act of 1944 to cover credit needs in connection with the termination of contracts. More general usage of the "T" loan by contractors was largely obviated by several factors, i.e., the rapidity with which many claims were liquidated after the conclusion of hostilities, the availability of partial payments on claims, and the liquid financial position of companies.

Three changes in administration occurred during the early stages of liquidation in 1945. First, after the German and Japanese surrenders the War and Navy Departments and the Maritime Commission determined that new war production loans should be authorized only in exceptional cases of clear necessity. Second, after consultation with the Office of Contract Settlement the War Department in September began closing its liaison offices at the Federal Reserve Banks (the last of these offices was closed in January 1946). Third, the War and Navy Departments delegated to the Federal Reserve Banks additional authority over outstanding loans, authorizing them at their discretion to approve extensions of loan maturities up to 60 days, waivers of default, and other acts of commercial lending institutions and users of guaranteed credit, provided the interest of the Government would not be materially affected by the desired adjustments.

Not only had the guarantee plan proved effective in making available commercial credit for necessary war production but as the program approached an end, it became evident that the V loan system had more than paid its own financial costs. From the inception of the plan to the end of 1945, the Reserve Banks collected 32.2 million dollars in guarantee and commitment fees for the account of the three guaranteeing agencies. Expenses of the Reserve Banks reimbursed by the three Services for which they were the agents amounted to 3.4 million dollars. The combined net receipts of the procurement agencies accordingly were 28.8 million dollars, and on December 31, 1945, it was estimated that their total losses would not exceed 6 million. This was an over-all ratio of losses to authorizations of 0.06 per cent.

Although a final accounting can not be had until the liquidation process is complete, certain aspects of this new experience in the guaranteeing of commercial loans to industry may be recorded at this time. The operation was decentralized to a considerable extent. The plan was utilized by nearly 1,400 banks and other commercial lending institutions. While these were a minority of all such institutions, their contribution to the war effort was disproportionately large; total war production loans under Regulation V amounted to 66 per cent of the estimated total of war production loans outstanding from all commercial banks on June 30, 1944, and to 54 per cent of that total at the beginning of 1945. The war-financing activity under Regulation V occurred preponderantly within the framework of the system of private enterprise in finance. The participating private institutions utilized their own funds exclusively except in the relatively few cases where they exercised their option at some later time to transfer some part of the risk to the procurement agencies. The plan provided a mechanism for financing the subcontractors as well as the prime contractors in war production.

The smallest credit guaranteed was for $400 and the largest for one billion dollars. Nearly 400 banks participated in the latter credit, of which only 100 million dollars was utilized. This credit, like many other guaranteed loans, was arranged for under the provisions of Regulation V because the guaranteed portion of Regulation V loans was not subject to legal limitations on the amount which might be lent to a single borrower. The maximum amount of this particular credit was in excess of the total lending capacity of all the commercial banks in the country (approximately 600 million dollars) on such loans to a single borrower.

Applicability of the guarantee plan to the financial problems of the smaller businesses was emphatically shown. Up to March 31, 1945, 62 per cent of the business borrowers were enterprises that had less than $500,000 in total assets when their first V loan was obtained. The amounts of credit placed at the disposal of these small enterprises were exceptionally large; for example, the average amount of authorization per borrower to enterprises with less than $50,000 in total assets was $97,000. Less than 8 per cent of the V loan borrowers up to the stated date were enterprises with as much as 5 million dollars in total assets. A valuable and in many respects new experience in the "tailoring" of commercial loans to fit the requirements of the individual borrowers was also a by-product of the experience under Regulation V. In spite of the fact that the higher proportions of risk coverage required the payment of larger fees, more than half of all guarantees provided coverage of the order of 90 per cent, and the average of all guarantees, up to the date stated above, was approximately 85 per cent. Every type of war production, from foods to metal products, textiles and chemicals, was financed under the plan.

BANKING OPERATIONS AND STRUCTURE

Bank earnings. Member bank net profits after taxes increased by 139 million dollars in 1945 and reached a new peak of 788 million. They had been rising steadily since 1942 and in 1943 had attained the highest point ever reported. Income from Government securities and profits on sales of such securities were the principal sources of income. About one-third of net profits was paid out as dividends and the remainder was added to capital accounts.

Earning assets of member banks exceeded 107 billion dollars at the close of 1945, having increased almost 16 billion during the year. In amount this increase was about the same as it had been in 1944 but as a percentage of total earning assets it was less than in any year since 1941. During the defense and war period, 1940-45, earning assets have almost trebled and an increasing proportion of the total has consisted of United States Government securities. At the end of 1945 this proportion was nearly 75 per cent.

The present level of bank profits, as compared with that of the late 1920's, results from circumstances markedly different from those prevailing at that time. Total earning assets of banks were about three times as large in 1945 as in 1929. The rate of interest return on these earning assets, however, was decidedly lower. While the level of market interest rates has fallen substantially for a decade and a half, the average return received by banks from earning assets has dropped even more. The composition of earning assets has shifted from a dominance of loans, a high-yield asset, to United States Government securities, the lowest yielding of all earning assets. At the same time, however, banking losses have declined greatly, while profits on securities sold and recoveries have expanded.

During 1945 member banks increased their holdings of United States Government securities by 11 billion dollars to 78 billions. They also increased their loans and holdings of other securities, as is shown in the accompanying table. Total loans increased to the largest amount outstanding since early in 1931. Loans on securities, which have increased sharply at times of war loan drives and declined between drives, continued at higher levels than in recent years.

MEMBER BANK LOANS AND INVESTMENTS

[In billions of dollars]

	Outstanding Dec. 31, 1945	Change during year	
		1945	1944
Loans—total	22.8	+4.1	+2.4
Commercial and industrial loans	8.9	+1.4	+0.1
Agricultural loans	0.9	−0.3	+0.2
Loans for purchasing or carrying securities	6.5	+2.2	+2.1
Real estate loans	3.5	+0.2	−0.1
Consumer loans	1.9	+0.4	......
All other, including loans to banks	1.1	+0.2	......
United States Government securities (direct and guaranteed)	78.3	+10.7	+14.7
State and local government securities	3.3	+0.4	+0.1
Other securities	2.8	+0.5	+0.1

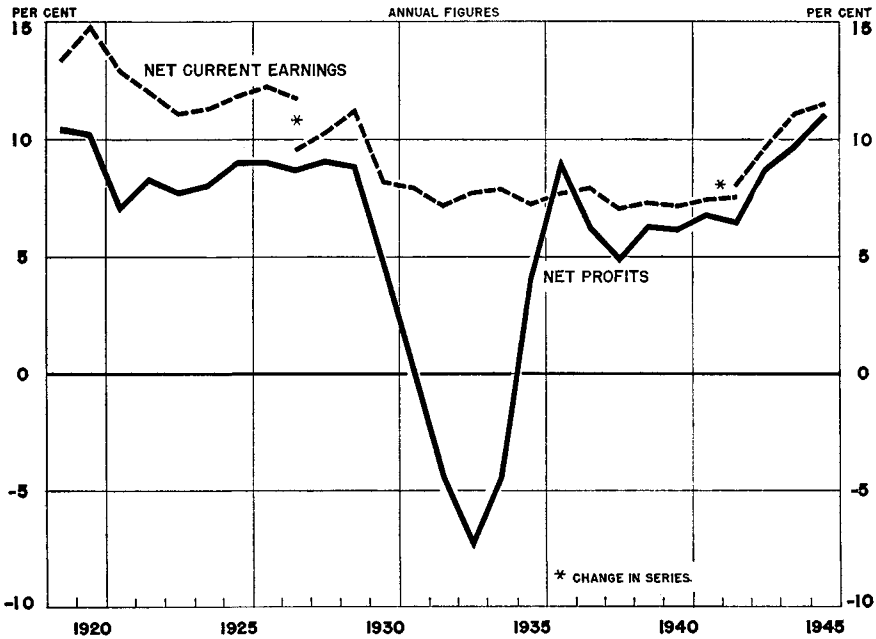
Commercial and industrial loans declined somewhat in the first half of the year, but increased considerably after the termination of hostilities. Since loans to finance war production were sharply curtailed in this period, it appears that loans for reconversion and for other civilian activities may have increased by over 2 billion dollars. At the end of 1945 total commercial and industrial loans at member banks were at the highest level in 15 years. Consumer loans by banks, which reached a low point in 1944, increased somewhat in 1945. There was also a small increase in real estate loans in the latter part of the year.

The wartime growth in earnings has been accompanied by a narrowing of differentials in the rate of return on earning assets among classes of banks and among individual banks. In 1940 the estimated average rate of return received from Government securities was almost twice as high at country banks as at money market banks. At present there is little difference between these groups of banks. Futhermore almost every bank, regardless of size, is now earning some profit. As is shown in the chart on page 36, member bank profits after taxes were almost 11 per cent of capital funds in 1945, a higher level than had been previously reached. The profit ratios of most banks clustered around this average, that is, fell within a range of about 9 to 12 per cent. The present level of net profits may be contrasted with net losses of over 7 per cent on capital funds in the depression year 1933.

It seems unlikely that bank profits will continue at the high levels of 1945, although they are not expected to decline in the near future to a level that will present difficulties for the banks. With the current debt retirement program of the Treasury, it is probable that bank earnings on Government securities

MEMBER BANK EARNINGS AND PROFITS

AS PERCENTAGES OF CAPITAL ACCOUNTS



Net current earnings are total earnings from current operations less current operating expenses. Net profits are net current earnings plus recoveries, profits on securities, etc., less losses and charge-offs and taxes on net income. Capital accounts consist of all forms of capital, including capital notes and debentures, surplus, undivided profits, reserves for contingencies, and other miscellaneous capital accounts. Prior to 1927 profits on securities were included in current earnings; beginning in 1942 taxes on net income were excluded, while recurring depreciation was included, as a current operating expense deduction from earnings.

have reached their peak. Earnings on loans, however, with their higher rates of interest, may increase. Bank expenses and taxes increased further in 1945, and somewhat higher expenses may be expected in 1946, although taxes will be lower. Any further expansion in the volume of bank credit or a rise in the general level of interest rates would tend to maintain bank profits at a high level, and possibly to increase them.

Capital accounts. Capital accounts of member banks increased 621 million dollars in 1945, compared with 493 million in 1944. Although there were some sales of additional capital stock, most of the increase was from profits remaining after dividend payments.

The increase of over 2 billion dollars in capital accounts of member banks since 1939 has not kept pace with the growth in deposit liabilities, but the growth in liabilities has been accompanied by increased holdings of Government securities. As a result, the percentage ratio of capital accounts of member banks to total assets other than Government securities and cash assets was 25 on December 31, 1945, practically unchanged from the ratio at the end of 1939.

Changes in number of banking offices. The total number of banking offices, other than offices at military reservations, increased by 112 in 1945 to 18,402. The preceding year there had been an increase of 12, the first reported since 1934. Notwithstanding this recent growth, there was a net decline of 261 between December 1939 and the close of 1945. This figure reflects a decline of 481 in the number of head offices and an increase of 220 in the number of branches and additional offices.

For the first year since 1934, when many banks were reopened after the banking holiday, there was a net increase in the number of banks (head offices) in 1945. During the year 118 new banks opened for business, of which 25 were member banks, 82 insured nonmember banks, and 11 noninsured banks. Through consolidation or otherwise, however, 100 head offices were discontinued. The net increase of 18 brought the number of banks in operation at the end of the year to 14,553. Of this total, 14,011 were commercial banks and 542 were mutual savings banks.

The number of branches and additional offices, other than offices at military reservations, increased by a net of 94 during the year to a total of 3,849. Since 1933 this number has increased in every year except 1942, when it remained unchanged.

The foregoing figures do not include banking facilities at military reservations, of which a considerable number were opened during 1943, 1944, and the early part of 1945. There were about 350 in existence on V-J Day, and at the end of the year there were 241. Including these facilities there were 18,643 banking offices at the end of 1945, comprising 14,553 banks, 3,849 branches, and 241 offices located at military reservations.

Increase in membership in Reserve System. Membership in the Federal Reserve System increased in 1945, as it has in every year since 1939, and registered a net gain of 70 banks for the year. The number of national banks decreased by a net of 8 while the number of State member banks increased by a net of 78. Eight of the 95 State banks admitted to membership were newly organized and 87 were already in operation. All but one of the 87 had previously been admitted to membership in the Federal Deposit Insurance Corporation. Total deposits of these 87 banks were about 378 million dollars. Over one-half of the State banks admitted to membership were located in three Federal Reserve districts—Cleveland, Chicago, and St. Louis.

The 6,884 member banks in operation at the end of 1945 accounted for 49 per cent of the number and 86 per cent of the deposits of all commercial banks in the country. These percentages compare with 44 and 86 respectively at the end of 1939. The State member banks of the Federal Reserve System accounted for 21 per cent of the total number and 69 per cent of the deposits of all State commercial banks. The corresponding percentages were 13 and 68 respectively in December 1939.

Par and nonpar banks. During 1945 there was a net increase of 324 in the number of banks on the Federal Reserve Par List and a net decrease of 312 in the number of nonpar banks.[1] This was a continuation of the trend of the past several years. The 2,133 banks not on the Par List at the end of 1945 represented only 15 per cent of all banks on which checks are drawn and held less than 2 per cent of the deposits of all commercial banks in the country. Corresponding figures for the end of 1939 were 2,719 banks, 19 per cent of all banks on which checks are drawn, and 2 per cent of deposits.

During 1945, 421 banks were added to the Par List, 5 withdrew from the Par List, and 92 par banks terminated existence.[2] Included in the banks added to the Par List were 151 banks in Nebraska, where the increase resulted from the enactment of a State par clearance law. (A similar increase of 111 banks occurred in 1943 as a result of State legislation in Iowa.) Other States in which there was a net increase of 10 or more par banks during 1945 included Tennessee 55, Texas 23, Illinois 18, Florida 16, and Virginia and Wisconsin 15 each.

At the end of 1945 there were 24 States and the District of Columbia in which all banks were on the Federal Reserve Par List, and 8 States in which the number of nonpar banks was 11 or less, as follows: Michigan 1, Kansas 2, Illinois 2, Nebraska 3, West Virginia 3, Montana 4, Washington 10, Oklahoma 11. The 16 other States that collectively had over 98 per cent of the banks not on the Par List at the end of 1945, were: Minnesota 418, Georgia 274, Mississippi 171, Arkansas 129, North Carolina 122, Wisconsin 119, Alabama 117, Tennessee 108, North Dakota 105, South Carolina 103, Louisiana and South Dakota 100 each, Missouri 76, Texas 68, Florida 66, and Virginia 21.

Check routing symbols. The American Bankers Association and the Federal Reserve Banks announced a plan early in June 1945 which will make it easier for banks to sort checks for collection through the Federal Reserve System. The Association distributed a booklet to all banks in the country describing the plan, and the Reserve Banks circularized all par remitting banks in their respective districts.

Under the plan "check routing symbols" were assigned by the Federal Reserve Banks to all par remitting banks. It was recommended that the symbol be printed in the upper right-hand corner of checks, above the dollar amount, in combination with the ABA transit number, which has been in use for years to identify the bank numerically. The ABA transit number appears as the

[1] The Federal Reserve Par List comprises all member banks, which are required under the law to remit at par for checks forwarded to them by the Reserve Banks for payment, and also such nonmember banks as have agreed to do likewise.

[2] Seventy-four of the 92 par banks that went out of existence were absorbed by other member and par nonmember banks, and 40 of the banks thus absorbed were converted into branches.

numerator and the check routing symbol as the denominator of a fraction, as in the following example:

$$\frac{55\text{-}146}{312}$$

In the example the first part of the ABA transit number (to the left of the hyphen) designates the reserve city or State in which the bank is located, and the second part designates a particular bank in that State. In the check routing symbol (the denominator of the fraction) the first digit designates the Federal Reserve District; the second digit designates the head office of the Federal Reserve Bank, a branch office, or a special collection arrangement; and the last digit indicates whether the check is receivable for immediate or deferred credit and the State in which the payor bank is located. In the example above, the first digit designates the Third Federal Reserve District, the second digit designates the Federal Reserve Bank of Philadelphia, and the last digit indicates that the item is receivable for deferred credit and that the payor bank is located in New Jersey.

A survey by the Federal Reserve Banks, based on checks handled in one week in February 1946, showed that about half of the approximately 12,000 banks that are on the Federal Reserve Par List have had the new check routing symbols printed on at least some of their checks.

RESERVE BANK OPERATIONS

Volume of operations. Operations of the Reserve Banks were in considerably larger volume in 1945 than in 1944, especially those relating to the issuance and redemption of securities and to other activities as fiscal agents of the United States.

Discount operations were somewhat larger than in recent years, and there

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1942–45

[Dollar amounts in thousands]

Item and year	Total	Discounts and advances	U. S. Government securities, direct and guaranteed	Industrial loans
Daily average holdings:				
1942	$3,209,649	$6,610	$3,191,259	$11,780
1943	7,761,651	24,759	7,724,488	12,404
1944	14,917,596	135,459	14,772,201	9,936
1945	21,742,567	375,958	21,363,244	3,365
Earnings:				
1942	$51,943	$65	$51,404	$474
1943	68,656	152	68,090	414
1944	103,837	724	102,810	303
1945	141,631	1,977	139,553	101
Average rate of earnings (per cent):				
1942	1.62	0.98	1.61	4.03
1943	0.88	0.61	0.88	3.34
1944	0.70	0.53	0.70	3.05
1945	0.65	0.53	0.65	2.99

was an increase in the Reserve Banks' holdings of Treasury bills acquired from member banks and others under agreements to resell upon demand prior to maturity at a discount rate of ⅜ per cent per annum. Holdings of Government securities in the System Open Market Account also increased. Industrial loan operations again declined, reaching the lowest level since the making of industrial loans and commitments by Federal Reserve Banks to provide working capital for industry was authorized in 1934. The table on page 39 shows daily average holdings during the past four years of discounts and advances, Government securities, and industrial loans, and average rates of earnings thereon.

Receipts and payments of paper currency and coin by the Federal Reserve Banks again increased, reflecting the large amount of currency in circulation. Issues and exchanges of Government securities and the volume of checks handled also increased substantially in 1945. Figures showing the volume of operations in principal departments are given in Table 5 on page 69.

Earnings and expenses. Current earnings, current expenses, and the distribution of net earnings of the various Federal Reserve Banks are given in detail in Table 6 on pages 70-71, and a condensed annual statement for all the Reserve Banks combined since 1913 is given on pages 72-73. The table below shows

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS, 1944 AND 1945

[In thousands of dollars]

Item	1944	1945
Current earnings	104,392	142,209
Current expenses	49,176	48,717
Current net earnings	55,216	93,492
Net additions to current net earnings	3,222	−830
Net earnings	58,438	92,662
Paid U. S. Treasury (Sec. 13b)	327	248
Dividends paid	9,500	10,182
Transferred to surplus (Sec. 13b)	201	262
Transferred to surplus (Sec. 7)	48,410	81,970
Total	58,438	92,662

a condensed summary for all of the Reserve Banks for the years 1944 and 1945. Current earnings were 142 million dollars in 1945 as compared with 104 million in 1944. Current expenses were about the same as in 1944, and net earnings amounted to 92 million dollars, or 34 million more than in 1944. After payments totaling 10 million dollars for dividends to member banks as provided in the Federal Reserve Act and payments to the United States Treasury under Section 13b of the Act relating to industrial loans, 82 million was added to the surplus of the Reserve Banks.

Foreign transactions. The volume of foreign transactions passing through the Federal Reserve Bank of New York continued large in 1945. The magnitude of these transactions on behalf of the United States Government departments and agencies declined sharply after V-J Day, amounting to about 40 million dollars in

December as compared with a monthly average of around 100 million during the summer and with a peak of over 200 million in January 1945. At the same time, other activities increased as relations were resumed with a number of central banks in countries formerly occupied by the enemy. At the end of 1945 the Federal Reserve Bank of New York held accounts for the central banks or governments of 60 foreign countries.

For the year as a whole, total foreign assets held at the Federal Reserve Bank of New York increased. The tendency in the latter months of the year was toward a reduction in the amount of dollar funds, which declined by an over-all amount of 340 million dollars for the year. At the year end these balances amounted to 861 million dollars as compared with the high of 1,246 million recorded in June and the all-time high of 1,650 million for May 1944. Holdings of United States Government securities for account of foreign central banks and governments increased from 960 million dollars in December 1944 to 1,696 million in October 1945, after which they declined to 1,654 million at the end of the year. Gold held under earmark rose from 3,937 million dollars in December 1944 to 4,294 million in December 1945. Exports and imports of gold were on a comparatively small scale. The Federal Reserve Bank of New York continued to operate the United States Exchange Stabilization Fund in accordance with authorizations and instructions from the Treasury. The Federal Reserve Banks also continued to act as agent for the Treasury in the administration of Foreign Funds Control.

During 1945 the Federal Reserve Banks made a series of short-term advances, secured by gold held in New York, to a Latin American central bank, the largest amount outstanding under this agreement being 12 million dollars. In addition, a short-term loan of 35 million dollars, also secured by gold in New York, was made to the government of a liberated European country. Both of these amounts were still outstanding at the close of the year.

Bank premises. The pressure for additional space at most of the Federal Reserve Banks and branches arising from expanded wartime operations was referred to in the *Annual Reports* for 1942 and 1943. Conditions in this respect have not improved, and it appears that most of the Federal Reserve Banks and branches will have to continue to rent outside space until such time as they can make additions to their present inadequate quarters or, in some cases, erect new buildings. The Board of Governors advised the Federal Reserve Banks during the year that, except in cases of urgent need, no building project should be undertaken until it is clear that labor and materials are readily available and the timing of the construction is in harmony with the postwar building program. Under this policy the only construction projects at Federal Reserve Banks authorized in 1945 were an additional story on the building occupied by the Helena Branch of the Federal Reserve Bank of Minneapolis, necessary repairs and improvements to the building acquired by the St. Louis Federal Reserve Bank in 1944, and completion of a vault and of air conditioning at the Federal Reserve Bank of Chicago.

Building sites for future expansion were acquired at the Pittsburgh, New Orleans, and Detroit Branches. A site for a building to house the Seattle Branch, which now occupies rented quarters, was also acquired during the year.

RESERVE BANK PERSONNEL

Chairmen and Deputy Chairmen. One of the Class C directors of each Federal Reserve Bank is designated annually to serve as Chairman and Federal Reserve Agent, and another Class C director is appointed annually as Deputy Chairman. A list of the Chairmen and Deputy Chairmen is shown on page 119.

The Chairman and Deputy Chairman at each of the twelve Federal Reserve Banks were redesignated to serve as such during the year 1945.

Directors. A list of directors of the Federal Reserve Banks and branches as of the close of the year is shown on pages 121-128.

The Board made the following appointments of new directors either for terms beginning January 1, 1945, or to fill vacancies during the year:

Class C Directors. On December 7, Russell L. Dearmont, Chief Counsel for Trustee, Missouri-Pacific Lines, St. Louis, Missouri, was appointed a Class C director of the Federal Reserve Bank of St. Louis.

On March 27, G. A. Frierson, a planter and merchant of Shreveport, Louisiana, was appointed a Class C director of the Federal Reserve Bank of Dallas.

Branch Directors. S. Headley Shouse of Lexington, Kentucky, was appointed a director of the Cincinnati Branch of the Federal Reserve Bank of Cleveland for a two-year term beginning January 1, 1945. Mr. Shouse is engaged in farming.

Paul G. Blazer, Chairman of the Board, The Ashland Oil and Refining Company, Ashland, Kentucky, was appointed a director of the Cincinnati Branch of the Federal Reserve Bank of Cleveland for a three-year term beginning January 1, 1945.

Howard W. Jordan, President, Pennsylvania Rubber Company, Jeannette, Pa., was appointed a director of the Pittsburgh Branch of the Federal Reserve Bank of Cleveland for the term beginning January 1, 1945.

On November 29, James F. Shriver, President, B. F. Shriver Company, Westminster, Maryland, was appointed a director of the Baltimore Branch of the Federal Reserve Bank of Richmond.

Ernest Gilbert of Waldron, Michigan, was appointed a director of the Detroit Branch of the Federal Reserve Bank of Chicago for the term beginning January 1, 1945. Mr. Gilbert is engaged in farming.

On March 12, Hal Bogle, Pecos Valley Alfalfa Mill Company, Dexter, New Mexico, was appointed a director of the El Paso Branch of the Federal Reserve Bank of Dallas.

J. E. Wheat of Woodville, Texas, was appointed a director of the Houston Branch of the Federal Reserve Bank of Dallas for the term beginning January 1, 1945. Mr. Wheat is an Attorney-at-Law.

John M. McGregor, Manager, McGregor Land and Livestock Company, Hooper, Washington, was appointed a director of the Seattle Branch of the Federal Reserve Bank of San Francisco for the term beginning January 1, 1945.

Changes in Presidents and First Vice Presidents. Mr. William A. Day, who had been an officer of the Federal Reserve Bank of San Francisco since July 1917 and President since April 1936, resigned as President on December 31, 1945, having availed himself of the privilege of retiring under the provisions of the Retirement System of the Federal Reserve Banks.

Mr. Day was succeeded as President, effective January 1, 1946, by Mr. Ira Clerk, who had served as First Vice President since April 1936. Mr. Clerk has been an officer of the Bank since it was organized in November 1914. Mr. Clerk, in turn, was succeeded as First Vice President by Vice President C. E. Earhart, who has been with the Bank since 1917 and who has served as an officer since 1920.

During the year the First Vice Presidents of two of the Federal Reserve Banks resigned to accept positions with commercial banks. Mr. H. P. Preston resigned as First Vice President of the Federal Reserve Bank of Chicago effective August 31, 1945, in order to accept the presidency of the Hamilton National Bank of Knoxville, Tennessee. Mr. Preston had served as an officer of the Federal Reserve Bank of Chicago since March 21, 1933, and as First Vice President since March 1, 1936. He was succeeded as First Vice President on October 25 by Vice President and General Counsel Charles B. Dunn. Mr. Dunn had served as General Counsel of the Federal Reserve Bank of Chicago since January 1, 1934. On February 26, 1942, he was appointed Vice President as well as General Counsel.

Mr. Reuben B. Hays resigned as First Vice President of the Federal Reserve Bank of Cleveland effective November 30, 1945, to become Executive Vice President of the First National Bank of Cincinnati, Ohio. Mr. Hays had been a member of the staff of the Federal Reserve Bank of Cleveland since July 10, 1934, an officer since February 16, 1935, and First Vice President since July 1, 1943. He was succeeded as First Vice President on December 1, 1945, by Vice President Wm. H. Fletcher. Mr. Fletcher has been a member of the Bank's staff since February 1918 and an officer of the Bank since July 1923.

Staff. At the end of the year the total number of officers and employees of the twelve Federal Reserve Banks and their twenty-four branches was 23,522, having declined by 920 after the end of 1944. This was the second successive year of decline following several years of successive increases due to the great expansion in the volume of operations accompanied by a high rate of turnover of personnel during the war years. The total number of officers and employees of the Reserve Banks and branches at the end of each year beginning with 1938 was as follows:

1938	10,919	1942	19,972
1939	11,355	1943	24,741
1940	11,640	1944	24,442
1941	14,083	1945	23,522

Effective November 1, 1945, the officer in charge of the El Paso Branch of the Federal Reserve Bank of Dallas was designated as a Vice President of the

Reserve Bank. Effective January 1, 1946, the officers in charge of the Little Rock, Louisville, and Memphis Branches of the Federal Reserve Bank of St. Louis were designated as Vice Presidents of the Reserve Bank and as Managers of the respective Branches. With these changes twelve of the twenty-four branches are now under the immediate direction of resident Vice Presidents of their Reserve Banks.

BANK SUPERVISION BY THE FEDERAL RESERVE

The volume of banking activities continued to expand during 1945. With the war effort a first consideration during the larger part of the year, Federal Reserve authorities endeavored to pursue examination and supervisory practices and policies which would further that effort in the banking field.

Examination of Federal Reserve Banks. The Board's Division of Examinations examined the twelve Federal Reserve Banks and their twenty-four branches during the year as required by law.

Examination of State member banks. State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to make at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. Wherever practicable, such examinations are made jointly in cooperation with State banking authorities or, by agreement with State authorities, alternate examinations are made.

The program for the examination of State member banks in 1945 was substantially completed with the close cooperation of State authorities, notwithstanding difficulties of travel and turnover in examining personnel.

Wartime conditions in 1945 made it impracticable to hold the customary conference of representatives of the bank examination departments of the twelve Federal Reserve Banks and of the Board for discussion of examination practices and procedures and formulation of supervisory policies and principles. However, the officers in charge of bank supervision at a number of the Reserve Banks visited the Board's offices for discussions and it was possible also to hold effective discussions between members of the Board's staff and representatives of the Reserve Banks who attended the meeting in New Orleans in November of the National Association of Supervisors of State banks.

Bank holding companies. During 1945 the Board acted upon applications for voting permits submitted by holding company affiliates of banks and authorized the issuance of six permits for general purposes and six permits for limited purposes.

Section 301 of the Banking Act of 1935 provides that the term "holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to four organizations.

Trust powers of national banks. Under the provisions of Section 11(k) of the Federal Reserve Act, the Board granted to 17 national banks authority to exercise one or more trust powers. This number includes the grant of additional powers to 2 banks which previously had been granted certain trust powers. Trust powers of 18 national banks were terminated, 11 by voluntary liquidation or consolidation and 7 by voluntary surrender. At the end of 1945, there were 1,788 national banks holding permits to exercise trust powers.

Increased acceptance powers. During the year the Board approved an application of a national bank made pursuant to the provisions of Section 13 of the Federal Reserve Act for permission to accept drafts and bills of exchange to an amount not exceeding at any one time, in the aggregate, 100 per cent of its paid-up and unimpaired capital stock and surplus. No other applications were received.

Foreign branches and banking corporations. The liberation of the Philippines and the surrender of Japan during the year, with the consequent release from Japanese domination of Far Eastern areas, made it possible for American banking institutions to regain control of their branches situated in that area. As soon as conditions permitted, the parent banks sent representatives to reopen their branches for such banking operations as were feasible, and progress was made generally in this respect despite the many difficult problems encountered. During the year, foreign branches of American banking institutions continued to perform an important function in facilitating import and export movements of strategic and other needed materials and supplies and furnishing banking facilities to our armed forces.

The Board received and approved one application made pursuant to the provisions of Section 25 of the Federal Reserve Act for permission to establish a foreign branch. No new foreign branches of member banks were established and no branches were closed during the year.

At the end of 1945, seven member banks were operating a total of 72 branches in 20 foreign countries or dependencies or possessions of the United States. Of the 72 branches, four national banks were operating 66 and three State member banks were operating 6. The foreign branches were distributed geographically as follows:

Latin America		42
Argentina	10	
Brazil	4	
Chile	2	
Colombia	3	
Cuba	16	
Mexico	1	
Panama	3	
Peru	1	
Uruguay	1	
Venezuela	1	
Continental Europe		2
Belgium	1	
France	1	
England		10
Far East		6
China	2	
India	2	
Hong Kong	1	
Straits Settlements	1	
U. S. Insular Possessions and Dependencies		12
Canal Zone	4	
Philippines	1	
Puerto Rico	7	
Total		72

During the year, the Board approved one application made pursuant to the provisions of Section 25 of the Federal Reserve Act relating to the investment by member banks in stocks of corporations engaged principally in international or foreign banking. The corporation entered into an agreement with the Board as required by the provisions of the Section and, with the Board's approval, established a branch in Paris during the year. Four other corporations organized under State laws have been operating for some years under similar agreements. Two of the four have no foreign branches, one operates a branch in England, and one has an English fiduciary affiliate.

There is only one banking corporation in active operation organized under the provisions of Section 25(a) of the Federal Reserve Act to engage in international or foreign banking. Its head office was examined during the year by the Board's Division of Examinations. The bank operates a branch in Paris, France, and following the surrender of Japan, reopened its branches in Tientsin and Shanghai, China, and in Hong Kong. It also operates a fiduciary affiliate in England.

RESEARCH AND ADVISORY SERVICES

During 1945 the current research and reporting work of the Board continued along the same lines as in other recent years, with emphasis on the study of war and postwar adjustments. Special attention was given to matters relating to Treasury finance, both because of the dominant importance of Government receipts and expenditures in the economic picture and more particularly because of their relation to System open market operations and to banking developments. Business finance was also given careful consideration, from the point of view of possible reconversion and postwar requirements. Membership of the Chairman of the Board of Governors on the Economic Stabilization Board provided the opportunity for an exchange of views with other governmental departments and agencies in the light of the responsibilities of the Federal Reserve System.

Labor and fiscal developments were carefully followed and interpreted, as were conditions in agriculture and housing. Considerable work was done in developing techniques for analyzing the composition of national income, for making projections of income and employment under varying assumptions, and for using these data in exploring the outlook for monetary and banking developments. Work was continued on the problems of measuring industrial production and on the analysis of current business trends. The Reserve Banks and the Board continued to collect and report data on department store sales and stocks. These series provide one of the few sources of information that reflect promptly the effect of reconversion in key metropolitan areas.

Semi-annual surveys of the ownership of demand deposits, the annual survey of the financial condition of business, particularly small business, conducted in cooperation with the Robert Morris Associates, and the current retail credit survey continued to provide important information as to individual and business holdings of liquid assets, as well as other significant financial data. Such data are particularly useful at this time to the Reserve System, to various governmental organizations, and to many private organizations.

During the year the Board of Governors also sponsored exploratory surveys, conducted by the Division of Program Surveys of the Bureau of Agricultural Economics (Department of Agriculture), of liquid holdings of individuals in Birmingham, Alabama, and Douglas County, Illinois. The results of these surveys aroused so much interest and proved to be of such assistance, not only to the Board and various Government agencies but also to other users of such data, that arrangements were made to have a nation-wide survey on the same subject conducted in the same manner early in 1946.

In the international field the Board's work expanded further in response to the growing importance of international problems. During the winter and spring there were many demands associated with congressional hearings and action on the Bretton Woods proposals. Ratification of these proposals placed additional responsibilities upon the Chairman of the Board of Governors as a member of the National Advisory Council on International Monetary and Financial Problems. The Chairman also served on the Advisory Board of the Export-Import Bank and as a member of the group of officials negotiating the British loan. As a consequence the responsibilities of the Board's staff for supplying information on foreign developments were increased.

On several studies of international matters members of the Board's staff worked with members of the staffs of various Government departments at times during the course of the year. Also during the year a special study on bank financing of exports and bankers' attitudes on the desirability of export credit insurance was made for a subcommittee of the Senate Small Business Committee.

On the request of various Governments and central banks, the Board contributed the services of members of its staff to help in the technical preparation of new monetary and banking legislation in several Latin American countries. As a result of such missions, far-reaching reforms were recently enacted in Paraguay and Guatemala. Similar work is currently being carried out in other countries, in collaboration with the Federal Reserve Bank of New York. In some cases assistance has had to be postponed because of the limited staff available for such missions. In the spring and summer the Board also lent the services of a member of its staff for the purpose of assisting in the rehabilitation of the banking system of the Commonwealth of the Philippines.

Members of the Board's staff continued to serve on many interdepartmental committees concerned with the development of economic information for the use of governmental authorities, thereby bringing the System's point of view to various officials and agencies and giving the Federal Reserve authorities a better opportunity to be familiar with work done elsewhere. Members of the staff also worked with members of the staff of a Senate Committee and of other Government agencies in connection with the Full Employment bill and assisted in the preparation of reports on other pressing subjects before Congress.

PUBLICATIONS AND RELEASES

There was a steadily increasing demand for the Board's publications and releases after the end of the war made it possible to discontinue the wartime restrictions on distribution. The monthly *Federal Reserve Bulletin* was issued for the 31st year. Three *Member Bank Call Reports* were released during the year, the complete *Par List* was issued in January and September followed by supplements in the other months, and in February a revised edition of Federal Reserve *Chart Book I* (Bank Credit, Money Rates, and Business) was published. Other publications included *State Bank Members of the Federal Reserve System and Nonmember Banks that Maintain Clearing Accounts with Federal Reserve Banks,* issued in January with monthly supplements thereafter; *The Retail Credit Survey—1944* and *Provisions of State Laws Relating to Bank Reserves,* issued in May.

Between August and December the Board published three of a special series of eight pamphlets in which members of its staff analyzed various postwar problems. It is anticipated that all the other pamphlets in the series will be published in 1946.

BOARD OF GOVERNORS—STAFF AND EXPENDITURES

Staff. On December 31, 1945, the Board's staff, exclusive of those on military leave or leave without pay, numbered 455, as compared with 448 at the end of 1944.

During the year 21 of the Board's permanent employees who had been on military leave rejoined the staff after their discharge from military service; 48 of the 74 permanent employees who had entered military service were still on military leave at the end of the year. Of the 25 employees who had resigned their temporary appointments to enter military service, two were reemployed by the Board during the year on their return to civilian life.

Lawrence Clayton, who had been Assistant to the Chairman of the Board of Governors since December 1934, resigned in January 1945 to become head of a securities company in Boston.

Elliott Thurston, who had been Special Assistant to the Chairman since May 1935, was appointed Assistant to the Chairman, effective February 1, 1945.

Dr. E. A. Goldenweiser, who had been a member of the Board's Division of Research and Statistics since March 1919, and Director of the Division since January 1927, was appointed to the newly created position of Economic Adviser effective February 1, 1945. Dr. Goldenweiser retired as a member of the Board's staff at the close of the year and became a member of the Institute for Advanced Study at Princeton, New Jersey.

Dr. Goldenweiser was succeeded as Director of the Division of Research and Statistics by Woodlief Thomas, who had been Assistant Director of the Division since November 1934. For 13 years prior to that time Mr. Thomas had been engaged in research work for the Federal Reserve System, serving at various times with the Federal Reserve Bank of Philadelphia, the Federal Reserve Bank of New York, and the Board.

Effective February 1, 1945, Howard S. Ellis was appointed Assistant Director of the Division of Research and Statistics. Mr. Ellis had been a member of the Division since September 1943, on leave of absence as Professor of Economics at the University of California.

J. P. Dreibelbis resigned as General Attorney effective March 15, 1945, to become a Vice President of a trust company in New York. Mr. Dreibelbis joined the staff of the Board in January 1936 as Assistant General Counsel and was appointed General Attorney in August 1942.

Effective March 16, 1945, George B. Vest was appointed General Attorney to succeed Mr. Dreibelbis. Mr. Vest has been a member of the Board's legal staff since 1922. In May 1935 he was appointed Assistant General Counsel, in which position he served until August 1942, when he was made Assistant General Attorney.

Effective March 1, 1945, J. Leonard Townsend was appointed by the Board of Governors as Assistant General Attorney.

Effective July 1, 1945, Chester Morrill, who had been Secretary of the Board since October 7, 1931, was appointed to the newly created position of Special Adviser to the Board of Governors, in which capacity he is concerned with matters of policy and procedure.

Effective as of the same date, S. R. Carpenter, who had been a member of the staff since 1926 and Assistant Secretary of the Board of Governors since May 18, 1933, was appointed Secretary.

William B. Pollard resigned as Assistant Director of the Division of Examinations as of the close of the year in order to accept appointment as Vice President of the Federal Reserve Bank of St. Louis with the designation of Manager of the Memphis Branch. Mr. Pollard had been a member of the Board's Division of Examinations since July 1933 and was made Assistant Chief of the Division on July 1, 1942.

Effective January 1, 1946, O. E. Foulk retired as Fiscal Agent under the provisions of the Federal Reserve Retirement System. At the same time the functions of his Office were transferred to the Board's Division of Administrative Services.

Chandler Morse was appointed Assistant Director of the Board's Division of Research and Statistics and assumed his new duties on January 2, 1946. Mr. Morse had served for a number of years on the staff of the Research Department of the Federal Reserve Bank of New York and with the Board's Division of Research and Statistics which he left in 1941 to become associated with the Office of Strategic Services.

During 1945 the Board's personnel continued to participate in the Pay Roll Savings Plan for the purchase of War Savings Bonds. Deductions from salaries for this purpose throughout the year averaged 14.6 per cent of gross pay roll.

Expenditures. The current expenses of the Board for the year 1945 aggregated $2,071,745. Two assessments were levied on the Federal Reserve Banks, representing about fifty-five hundredths of one per cent of their average paid-in capital and surplus for the year, to cover the general expenses of the Board. Details are shown in the following table:

RECEIPTS AND DISBURSEMENTS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR THE YEAR 1945

General fund account:				
Balance January 1, 1945:				
For general expenses of the Board			$223,035.31	
For expenses chargeable to Federal Reserve Banks			33,362.23	
For purchase of United States Savings Bonds for employees under Board's Voluntary Pay Roll Savings Plan			7,735.30	
For income tax withholdings due Collector of Internal Revenue			58,304.80	$ 322,437.64
RECEIPTS				
For general expenses of the Board:				
Assessments on Federal Reserve Banks for estimated general expenses of the Board		$2,340,509.55		
Subscriptions to the Federal Reserve Bulletin		7,115.58		
Other publications, sales		3,261.99		
Reimbursements for leased wire service		53,668.24		
Cafeteria operations		66,324.38		
Miscellaneous receipts, refunds, and reimbursements		15,034.24	2,485,913.98	
For expenses chargeable to Federal Reserve Banks:				
Assessments on Federal Reserve Banks for:				
Cost of printing Federal Reserve notes		3,231,159.75		
Expenses of leased wire system (telegraph)		61,171.16		
Expenses of leased telephone lines		10,300.75		
Expenses of Federal Reserve Issue and Redemption Division (Office of the Comptroller of the Currency)		45,744.28		
Miscellaneous expenses		5,848.92	3,354,224.86	
Employees' pay roll allotments for purchase of United States Savings Bonds			230,598.20	
Income tax withheld from salaries			255,982.43	
Total receipts				6,326,719.47
Total available for disbursement				6,649,157.11
DISBURSEMENTS				
For expenses of the Board:				
Current expenses of 1945 (per detailed statement)	$2,071,744.64			
Less accounts unpaid December 31, 1945	145,801.17	1,925,943.47		
Expenses of prior years paid in 1945		57,425.50		
Expenses of leased wire service, reimbursable		53,205.27		
Cafeteria operations		61,591.49		
Miscellaneous refunds and items reimbursable		7,809.99	2,105,975.72	
For expenses chargeable to Federal Reserve Banks:				
Cost of printing Federal Reserve notes		3,002,148.45		
Expenses of leased wire system (telegraph)		61,856.12		
Expenses of leased telephone lines		9,000.75		
Expenses of Federal Reserve Issue and Redemption Division (Office of the Comptroller of the Currency)		45,744.28		
Miscellaneous expenses		2,595.25	3,121,344.85	
Purchase of United States Savings Bonds and refunds under Board's pay roll plan			227,904.75	
Collector of Internal Revenue—income tax withheld from salaries			253,762.13	
Total disbursements				5,708,987.45
Balance in general fund account December 31, 1945:				
For general expenses of the Board			602,973.57	
For expenses chargeable to Federal Reserve Banks			266,242.24	
For purchase of United States Savings Bonds for employees under Board's Voluntary Pay Roll Savings Plan			10,428.75	
For income tax withholdings due Collector of Internal Revenue			60,525.10	
				$ 940,169.66

RECEIPTS AND DISBURSEMENTS—Continued

CURRENT EXPENSES

Personal services:	
Salaries	$1,620,453.27
Retirement contributions	124,640.39
Total personal services	$1,745,093.66
Nonpersonal services:	
Traveling expenses	99,328.38
Postage and expressage	16,806.62
Telephone and telegraph	47,988.85
Printing and binding	66,853.11
Stationery and supplies	14,322.92
Furniture and equipment	5,503.70
Books and subscriptions	7,449.61
Heat, light, and power	24,710.77
Repairs and alterations (building and grounds)	2,703.89
Repairs and maintenance (furniture and equipment)	3,165.12
Medical service and supplies	839.94
Insurance	4,050.34
Cafeteria operations	14,363.84
Liquid assets survey	7,500.00
Legal fees and expenses	2,527.98
Miscellaneous	8,535.91
Total nonpersonal services	$ 326,650.98
GRAND TOTAL	$2,071,744.64

Under an arrangement with the Federal Reserve Bank of Richmond, the accounts of the Board for the year 1945 were audited by the Auditor of the Bank, who certified them to be correct.

FEDERAL RESERVE MEETINGS

The Federal Open Market Committee met in Washington on February 28, March 1, June 20, and October 17, 1945, and the executive committee of the full committee met from time to time during the year. Under the provisions of Section 12A of the Federal Reserve Act, the Federal Open Market Committee has responsibility for determining the policies under which the open market operations of the Federal Reserve Banks shall be carried out. A record of the actions taken by the Committee on questions of policy will be found on pages 90-93 of this report.

A Conference of the Chairmen of the Federal Reserve Banks was held on October 29 and 30, 1945, and was attended by the members of the Board of Governors.

The Conference of Presidents of the Federal Reserve Banks held meetings on February 26-27, June 18-19, and October 15-16, 1945, and the Board of Governors met with the Presidents on February 28, March 1-2, June 21, and October 18, 1945.

Meetings of the Federal Advisory Council were held on February 18-19, May 13-14, September 16-17, and November 18-19, 1945, and the executive committee of the Council met on June 13 and October 3, 1945. The Board of Governors met with the Council or its executive committee on each of these occasions. The Council is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with and advise the Board on all matters within the jurisdiction of the Board.

During the year several conferences, attended by representatives of the Federal

Reserve Banks and the Board of Governors, were held to discuss monetary and credit developments, international monetary relationships, personnel administration, bank operations, services to member banks, and other System problems.

LEGISLATION AND REPORTS TO CONGRESS

Currency and reserves of Federal Reserve Banks. By an Act of Congress approved June 12, 1945, the reserve requirements of Federal Reserve Banks were reduced to a uniform amount of 25 per cent in gold certificates against Federal Reserve notes and an equal amount against deposit liabilities. The Act also extended indefinitely the authority for the use of direct obligations of the United States as collateral security for Federal Reserve notes and terminated the authority of the Federal Reserve Banks to issue Federal Reserve Bank notes. In addition, the authority of the President and the Secretary of the Treasury with respect to the issuance of United States notes under the Thomas Amendment of May 12, 1933 was terminated.

Bretton Woods Agreements Act; National Advisory Council on International Monetary and Financial Problems. The "Bretton Woods Agreements Act," approved July 31, 1945, provided for the participation of the United States in the International Monetary Fund and the International Bank for Reconstruction and Development. Among other things, it made provision for Federal Reserve Banks to act as depository or fiscal agent for the Fund or the Bank under the supervision of the Board of Governors of the Federal Reserve System.

The Act established the National Advisory Council on International Monetary and Financial Problems consisting of the Secretary of the Treasury as Chairman, the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Board of Trustees of the Export-Import Bank of Washington. The Act placed important responsibilities on the Council and specifically provided that it "shall coordinate, by consultation or otherwise, so far as is practicable, the policies and operations of the representatives of the United States on the Fund and the Bank, the Export-Import Bank of Washington and all other agencies of the Government to the extent that they make or participate in the making of foreign loans or engage in foreign financial, exchange or monetary transactions."

Advisory Board of Export-Import Bank of Washington. The "Export-Import Bank Act of 1945," approved July 31, 1945, increased the bank's lending authority and made certain other changes. Among other things, it provided for an Advisory Board consisting of the Chairman of the Export-Import Bank, who shall serve as Chairman, the Secretary of State, the Secretary of the Treasury, the Secretary of Commerce, and the Chairman of the Board of Governors of the Federal Reserve System. The Advisory Board may make such recommendations to the Board of Directors of the Bank as it deems advisable, and the Board of Directors shall consult the Advisory Board on major questions of policy.

Purchase of Government obligations directly from the United States. By an Act of Congress approved December 28, 1945, the period during which the Federal Reserve Banks can purchase obligations of the United States directly from the United States was extended until June 30, 1946, unless sooner terminated by Congress or the President. The total amount of securities that can be purchased under this provision continues to be limited to 5 billion dollars held at any one time.

Veterans' guaranteed loans. Certain limitations contained in Section 24 of the Federal Reserve Act upon real estate loans by national banks, were, in effect, set aside by the Act of December 28, 1945, in so far as they relate to loans to veterans guaranteed under the Servicemen's Readjustment Act of 1944.

Reports to Congress. On several occasions during the year, members of the Board were called upon to appear before committees of Congress to give information on proposed legislation. At the request of such committees, and of the Bureau of the Budget, the Board submitted reports on proposed legislation relating to currency and reserves of Federal Reserve Banks, the Bretton Woods Agreements, the Export-Import Bank of Washington, the promotion of maximum employment and production, Government reorganization, increase in the limit on the Federal debt, credit for small business, amendments to the Clayton Anti-Trust Act, loans to veterans, various aspects of the Federal Home Loan Bank System, revaluation of gold, certain suits against national banks, authorization to carry Government obligations at par, and certain types of real estate loans.

Pre-1945 legislation during defense and war period. Although existing law provided much of the necessary authority, the System's vital part in the defense and war efforts was also reflected in legislation passed during this period.

Acts of May 7, 1940 and December 18, 1941 made certain technical and clarifying amendments to Section 5(b) of the Act of October 6, 1917, known as the Trading With the Enemy Act, and confirmed actions taken under the provision. This section, under which the Presidential Proclamation of a "Bank Holiday" had been issued in 1933, was the basis for Presidential Executive Orders by which, beginning in 1940, transactions in funds or other property of invaded countries were subjected to licensing by the Secretary of the Treasury. Reports as to such funds or property, as well as applications for licenses, were required to be filed with the Federal Reserve Banks.

It was under the same provision of the Trading With the Enemy Act that the President, by Executive Order No. 8843 on August 9, 1941, authorized and directed the Board of Governors to exercise a measure of control over consumer credit during the emergency arising out of World War II.

The growing need for defense housing led to the enactment of special legislation for insuring defense housing mortgages. An Act of March 28, 1941 exempted such insured mortgages from the limitations in Section 24 of the Federal Reserve Act on the amounts and maturities of real estate loans by national banks.

Uncertainties regarding the ownership of funds of the invaded countries led to the passage of the Act of April 7, 1941, providing a procedure whereby Reserve

Banks and insured banks may safely make payments of amounts due to foreign governments or central banks in such cases. The Act also clarified the authority of Reserve Banks to maintain banking accounts for foreign banks and governments without having to establish reciprocal accounts with them.

In connection with the existing provisions of law relating to the System's important functions in endeavoring to promote stability in the Government securities market, there were two amendments, largely procedural in character. The first, contained in the "Second War Powers Act of 1942" approved March 27, 1942, authorized the Reserve Banks to purchase United States obligations directly from the United States. The total amount so purchased was limited to 5 billion dollars held at any one time. The authority for such direct purchases was limited to December 31, 1944, unless terminated earlier by Congress or the President. An Act approved December 20, 1944 extended this date to December 31, 1945, and as indicated previously, an Act of December 28, 1945, extended it to June 30, 1946.

The second amendment on the subject was contained in the Act of July 7, 1942. This regrouped the Federal Reserve Banks for the purpose of electing the Reserve Bank representatives on the Federal Open Market Committee, which is composed of the members of the Board of Governors and five representatives of the Federal Reserve Banks. The regrouping provided continuous representation on the Committee for the Federal Reserve Bank of New York, which is located in the principal capital market and acts as the agent for the Committee in the operation of the System's open market account. The tremendous financial operations of the war required certain changes in the reserve requirements of member banks, but these were largely adjustments rather than fundamental alterations. The Act of July 7, 1942 authorized the Board of Governors to change reserve requirements of member banks in central reserve cities, within existing limitations, without necessarily changing the requirements for reserve cities. It also repealed the prohibition against member banks making new loans or paying dividends while their reserves are deficient. The Act of April 13, 1943 provided that, until six months after the cessation of hostilities as declared by Congress or the President, "war loan deposit accounts" (deposits payable to the United States arising solely as a result of subscriptions for United States securities) should be exempt from the reserve requirements applicable to member banks. It also exempted such deposits in insured banks from deposit insurance assessments during the same period. The Act of June 11, 1942 permitted the Secretary of the Treasury to appoint any insured banks as depositaries of public moneys, in effect repealing the requirement that only member banks could be such depositaries.

It was, of course, essential throughout this period that the Reserve Banks continue to have authority to use United States obligations as collateral for Federal Reserve notes. This authority had originally been enacted on February 27, 1932, to last until March 3, 1933. It was repeatedly extended for short periods;

including extensions in 1941 and 1943. As previously indicated, it was finally made permanent by the Act of June 12, 1945.

Under the Presidential Executive Order No. 9112 of March 26, 1942, and Acts approved October 9, 1940 (Assignment of Claims Act of 1940), June 11, 1942, and July 1, 1944 (Contract Settlement Act of 1944), the System provided valuable assistance to individual war contractors, particularly small contractors, in obtaining financing from banks. The Reserve Banks, under the general supervision of the Board of Governors, acted as Fiscal Agents for the War and Navy Departments and Maritime Commission in guaranteeing loans made by financing institutions to war contractors. As indicated in the references to Regulation V under the discussion of changes in the Board's regulations, this financing covered both production and contract termination claims—so-called "V" loans, "VT" loans, 1944 "V" loans, and "T" loans.

CHANGES IN REGULATIONS OF THE BOARD OF GOVERNORS

Foreign banking corporations. Effective February 2, 1945, the Board amended the second paragraph of Section XV of Regulation K, which relates to "Banking Corporations Authorized to do Foreign Banking Business under the Terms of Section 25(a) of the Federal Reserve Act," commonly known as Edge Act Corporations, so as to provide that with the permission of the Board the limitation placed on the aggregate liabilities of such a corporation may be exceeded.

Consumer credit. Effective February 5, 1945, the Board amended Regulation W relating to consumer credit so that the existing exemption of veterans' loans that are guaranteed by the Veterans Administration would also apply to veterans' loans guaranteed by similar State agencies.

Effective June 11, 1945, Regulation W was amended in several respects. The changes were chiefly of a technical and administrative nature relating to repairs or improvements of residential property, the so-called "summer plans" for specified home improvement items, and the exemption for certain "disaster credits."

Effective July 27, 1945, certain technical and administrative changes were made in the exemptions relating to credits for aircraft, agricultural loans, and railroad watches.

Effective October 15, 1945, the regulation was amended to exempt credits for home repairs and improvements and to lengthen from 12 months to 18 the maturity limitation on loans which are not for the purpose of purchasing consumers' durable goods.

Effective December 1, 1945, another amendment was adopted which was primarily of the nature of a technical or clarifying supplement to the preceding amendment. It permits outstanding obligations to be renewed or revised so as to obtain the benefit of any increase in maximum maturity authorized by any changes in the regulation made since the obligation arose. It also permits an 18 months' maturity for consolidated obligations if none of the additional credit is to be used to purchase consumers' durable goods. In addition, the amendment restored to the regulation provisions effective prior to May 1942, which relieve an automobile salesman from having to meet the standard requirements when he buys a car to be used as a demonstrator.

Margin requirements for purchasing securities. On two occasions in 1945, the Board amended Regulation T entitled "Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges," and Regulation U, entitled "Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange." The first amendments, effective February 5, 1945, increased the 40 per cent margin requirements for purchasing registered securities to 50 per cent, the figure already applicable to short sales.

Effective July 5, 1945, these regulations were further amended to increase the margin requirements to 75 per cent for purchases of registered securities. The increased margins also applied to short sales. At the same time provisions were adopted, to become effective July 16, 1945, making certain changes in the regulations to simplify and strengthen the supporting rules. The new provisions required that the proceeds of sales of securities in accounts that are undermargined under the new requirements shall be used to the extent necessary to increase the margin on the remaining securities in the account until they are up to the new requirements. Except to this extent, neither regulation required that existing accounts or loans be brought up to the level of the new requirements. As in the past, neither regulation applied to loans for purposes other than purchasing, carrying, or trading in securities.

Effective January 21, 1946, Regulations T and U were amended to increase margin requirements to 100 per cent for both purchases of registered securities and short sales. The rules that became effective in July 1945 continued to require that the proceeds of liquidations be used to bring undermargined accounts up to the level required for new commitments.

Reserves of member banks. Effective August 1, 1945, the Board amended Section 2(*a*) of Regulation D relating to reserves of member banks, so as to provide that a member bank with its head office or any branch office located in a central reserve city shall be considered to be in a central reserve city for reserve purposes and a member bank with any office in a reserve city but no office in a central reserve city shall be considered to be in a reserve city. However, a member bank considered to be in a central reserve or reserve city solely by reason of the location of an office in an outlying district of such a city may obtain permission, upon the affirmative vote of five members of the Board of Governors, to carry lower reserve balances.

Common trust funds. Effective September 1, 1945, the Board amended Section 17 of Regulation F entitled "Trust Powers of National Banks" so as to increase from $25,000 to $50,000 the amount of the funds of any one trust which may be invested in a common trust fund. At the same time, the Board adopted other amendments to the common trust fund provisions of the regulation to provide restrictions on a bank's advertising of such funds and to make certain other minor changes, principally of a clarifying nature. Corresponding changes also were made in the provisions relating to mortgage investment funds.

Pre-1945 changes in Board's regulations during defense and war period. Changes in the Board's regulations reflected chiefly changes in underlying statutes. Two new regulations, Regulation W, relating to consumer credit, and Regulation V, relating to the financing of war production and war contract termination, grew out of Presidential Executive Orders.

Regulation W was originally issued on August 21, 1941, to become effective September 1, 1941. It then applied only to instalment sales and instalment loans, and covered a fairly limited list of consumer durable goods. Amendments effective March 23 and May 6, 1942, brought charge accounts and single-payment loans under the regulation, broadened the list of articles to include almost all kinds of consumer durable and semi-durable goods, and also further restricted the credit terms available under the regulation.

There were a number of other amendments to Regulation W. Some were for the purpose of improving its practical working; but until the relaxations mentioned above in 1945, most of the changes were made to support various phases of the war program sponsored by other branches of the Government.

Regulation V was issued effective April 6, 1942, pursuant to the President's Executive Order No. 9112 of March 26, 1942. The regulation provided the general framework for a highly successful war program under which the Federal Reserve Banks, under the supervision of the Board of Governors, acted as agents for the War and Navy Departments and the Maritime Commission in guaranteeing loans made by banks for the purpose of financing war production contractors. Within this general V loan framework, and without amendment to the regulation, the program was extended in September 1943 to include so-called VT loans which provided contractors with protection against termination of their war contracts, as well as funds for current production. After the enactment of the Contract Settlement Act of 1944, the regulation was amended, effective September 11, 1944, to cover the making of T loan guarantees for the purpose of financing contractors after cancellation of their contracts.

Effective April 30, 1942, the Board of Governors made certain clarifying and technical changes in Regulation S, relating to loans by Federal Reserve Banks to commerce and industry under Section 13b of the Federal Reserve Act, in order further to facilitate Federal Reserve participation in the financing of war production.

Effective March 20, 1942, Regulation A, relating to discounts for and advances to member banks by Federal Reserve Banks, was amended to clarify the authority of Reserve Banks to make 90-day advances to member banks on the security of direct obligations of the United States. Effective September 18, 1942, the regulation was amended so that paper guaranteed pursuant to Executive Order No. 9112 need not be negotiable in order to be eligible for discount by a Federal Reserve Bank. Effective September 11, 1944, there was a further amendment to apply the same rule to paper guaranteed pursuant to the Contract Settlement Act of 1944.

Regulation D, relating to reserve requirements of member banks, was amended a number of times in 1942. This was to conform to changes in the law and also to release reserves to banks in central reserve cities by reducing requirements on their demand deposits in three steps from 26 per cent to 20 per cent. All member banks in central reserve and reserve cities were given permission to average their required reserves over a weekly period. Previously reserves of banks in Federal Reserve Bank and branch cities, and in three other nearby cities, were averaged over semi-weekly periods. The regulation was amended in 1943 to conform to the statutory changes exempting war loan deposit accounts from reserve requirements.

LITIGATION

Injunction under Regulation W. A decree restraining Consumers Home Equipment Co. and A. B. Chereton, its President, from violations of Regulation W of the Board of Governors of the Federal Reserve System was entered on July 19, 1945, in the District Court of the United States for the Eastern District of Michigan, Southern Division.

The Consumers Home Equipment organization, which has its head office at Detroit, Michigan, and offices in Illinois, Indiana, Kentucky, Michigan, New York, Ohio, and Pennsylvania, and affiliates with offices in Maine, Massachusetts, New Hampshire, Rhode Island, and West Virginia, is engaged in the house-to-house sale of household merchandise on an instalment basis. The company was charged with violating the regulation in a number of instances by making sales without obtaining the down payment required, by failing to furnish statements of transactions to customers, and by not only failing to maintain records but attempting to conceal violations by manipulation and alteration of its records.

The effect of the decree, to which the defendants consented, is to render the defendants liable for punishment for contempt of court in the event they are found in the future to have violated the regulation in any of the respects described in the decree.

The text of the decree appears in the Appendix at page 94.

Suit regarding condition of membership. In 1944 the Peoples Bank, Lakewood Village, California, brought suit in the District Court of the United States for the Northern District of California against the Federal Reserve Bank of San Francisco, the Board of Governors of the Federal Reserve System, and the Federal Reserve Agent at San Francisco. The complaint alleged that a condition of membership which had been prescribed when the Peoples Bank became a member of the Federal Reserve System was unauthorized by law and asked for a declaratory judgment and for an injunction restraining the defendants from enforcing the condition. Defendants filed separate motions to dismiss the suit.

The District Court in an opinion rendered November 17, 1944, and set out in the Appendix at pages 95-101, granted these motions of the defendants.

An appeal to the United States Circuit Court of Appeals for the Ninth Circuit was taken by the plaintiff as to the Federal Reserve Bank and the Federal Reserve Agent, and a cross appeal was taken by the Federal Reserve Bank.

On June 29, 1945, the Circuit Court of Appeals rendered a decision dismissing the appeals. The opinion of the Court appears in the Appendix at pages 102-103.

On December 24, 1945, the Peoples Bank filed suit in the District Court of the United States for the District of Columbia against the individual members of the Board of Governors. The allegations and requested relief were similar to those in the California litigation.

Suit regarding removal of bank directors. On April 30, 1945, suit was filed in the District Court of the United States for the District of Columbia by John Agnew and F. O. Fayerweather against the Board of Governors of the Federal Reserve System and the individual members thereof to review an order of the Board issued pursuant to authority conferred by Section 30 of the Banking Act of 1933, removing plaintiffs as directors of a national bank in Paterson, New Jersey. The removal order was predicated upon a finding that plaintiffs had violated Section 32 of the Banking Act of 1933, which prohibits any officer, director or employee of any company, partnership or individual primarily engaged in the business of underwriting securities from serving at the same time as an officer, director or employee of any member bank of the Federal Reserve System. Plaintiffs contended in effect that the use of the words "primarily engaged" in Section 32 limited its application to cases in which the underwriting business of the securities company is first in volume as compared with other businesses in which it is engaged and that, since this was not true of the securities company of which they were employees, the statute was not applicable to them.

Motions were filed by the defendants challenging the jurisdiction of the court to entertain proceedings to review the Board's order in this case and also challenging plaintiffs' interpretation of the law as set forth above. The motions were granted by the District Court and the suit dismissed.

The plaintiffs appealed the case to the United States Court of Appeals for the District of Columbia. On February 13, 1946, the Court, speaking through Justice Prettyman, rendered an opinion reversing the District Court. Justice Edgerton dissented. The opinion of the Court appears in the Appendix at pages 104-114 followed by the dissenting opinion at pages 114-116.

On April 29, 1946, the Supreme Court of the United States granted a petition for a writ of certiorari to review the decision of the Court of Appeals.

ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

During 1946 inflationary developments gained impetus in the United States. In the last half of the year, after the abandonment of most of the stabilization controls, commodity prices in general rose more sharply than in any period of similar length since 1917. Many prices were close to or above previous peaks. Unusually wide variations in rates of increase for different commodities and services were creating serious distortions in the price structure. As the year ended it remained to be seen how far inflationary influences had spent their force or whether they might lead to further price rises.

This inflationary aftermath of wartime monetary expansion and shortages of goods occurred notwithstanding rapid reconversion to peacetime production and a lessening of the inflationary impact of current fiscal and monetary developments. During the war, as explained in the Board's *Annual Report* for 1945, requirements of war finance had necessarily dominated fiscal and monetary policies. Because of the wartime excess of current incomes (after taxes) over goods and services available for purchase, there was an inevitable growth in liquid assets, i.e., bank deposits, currency, and Government securities, held by individuals and businesses. This high degree of liquidity, together with heavy current and deferred demands and continued shortages of goods and services, generated strong pressures toward rising prices during the transition period.

Notwithstanding shortages of materials, industrial strife, and other obstacles, production of civilian goods increased rapidly to new high levels in 1946. Millions of demobilized veterans and workers released from other war activities were quickly absorbed in peacetime pursuits. Incomes rose above the wartime peak. Consumers' expenditures showed a phenomenal and generally unexpected expansion; business inventories increased rapidly, and there were unusually large additions to plant and equipment. Construction increased greatly as additional supplies of materials became available. Finally, the endeavor to meet urgent shortages in other countries resulted in a volume of exports larger than in any previous peacetime year. These demands more than offset the effects of the further decline in Government war expenditures.

MONETARY SITUATION IN 1946

Monetary and credit expansion slackened in 1946. Following the ending of hostilities the Federal Government's budgetary deficit was drastically reduced, and for the year as a whole the Treasury's cash receipts exceeded cash payments. About 23 billion of the 280 billion dollar public debt outstanding at the end of February was paid off in 1946 by drawing upon large Treasury deposits built up at commercial banks during the Victory Loan Drive. The reduction in public debt was reflected in a decrease in bank holdings of Government securities and in bank loans on such securities, as well as in Government deposits at banks. Important trends of war years were thus reversed.

Bank loans increased sharply in 1946 and at the end of the year total loans of all banks were larger than at any time since 1930. Loans to commerce and industry, to owners of farms, homes, and other real estate, and to consumers accounted for the 1946 expansion. In part, these increased loans to private borrowers reflected the credit needs of the expanding peacetime economy, but some of the credit extended was probably used for speculative purposes. In either case the loans added to the capacity of borrowers to bid for scarce resources and augmented inflationary pressures. The increase in consumer loans, which reflected in part the growing supply of consumers' durable goods, was restricted somewhat by the Board's Regulation W. Toward the end of the year this regulation was substantially amended, principally by releasing noninstalment credits from its restrictions.

Bank loans on securities declined sharply over the year. Most of the decrease was in loans to finance the purchase of Government securities, but stock market credit also declined. In the early months, when stock prices were rising and the market was active, the reduction in credit reflected action by the Board in January raising margin requirements from 75 to 100 per cent to prohibit further extensions of credit for purchasing or carrying stocks. Later in the year declining stock prices also contributed to liquidation of stock market credit.

Total bank deposits decreased during the year, owing to the use of Treasury balances to retire bank-held Government securities. Deposits held by the public, however, continued to increase, although at a slower rate than during the war years. The public's total holdings of liquid assets also expanded at a more moderate pace than in the war years. Corporations maintained their bank deposits at a high level, but reduced their holdings of Government securities, while individuals continued to expand their deposits and made little change in their holdings of Government securities. Growth of currency in circulation, which had been rapid in wartime, virtually ceased in 1946.

Retirement of the public debt by the Treasury had the effect of putting some pressure on the reserve positions of banks and thus tended to restrict further expansion of bank credit. Of the securities retired 4.5 billion dollars were held by the Federal Reserve Banks and the redemption of these securities with funds drawn from commercial banks reduced bank reserves. Retirement of securities held by nonbank holders resulted in a shift of deposits from Treasury war loan accounts, against which no reserves were required to be held, to other accounts, against which reserves were required, and thus increased the reserve needs of banks. Retirement of bank-held debt reduced Treasury deposits at banks and bank holdings of short-term securities by corresponding amounts and had no effect on the reserve position of banks. In addition to these pressures, the deposit growth resulting from loan expansion also increased the reserve needs of banks. Banks, therefore, in addition to having their securities portfolios reduced by debt retirement, had to sell Government securities to the Reserve System in order to maintain their reserve positions.

Another factor putting some restraint on expansion of bank credit was the discontinuance by the Federal Reserve Banks of their preferential discount rate of ½ per cent on advances to member banks secured by Government securities maturing or callable within one year. This action, taken in the spring, made it necessary for borrowing banks to pay the regular discount rate of one per cent and thereby discouraged the practice being followed by some banks of borrowing to meet reserve needs instead of liquidating Government securities.

Pressures resulting from these developments greatly diminished further monetization of the public debt by the banking system, to which attention was called in the Board's *Annual Report* for 1945. During 1945 and the early part of 1946 banks had increased their holdings of Government securities, particularly of long-term issues. This expansion was based in part on excess reserves temporarily available during war loan drives and more permanently on reserve funds obtained through sales of short-term low-rate issues to the Federal Reserve System at the established pattern of rates. The reserves created provided the basis for a multiple credit expansion. This practice had the effect of expanding bank deposits and of depressing long-term interest rates. Under the changed banking conditions prevailing during most of 1946, banks were less inclined to sell short-term securities for the purpose of expanding further their holdings of longer-term securities, and largely confined such sales to meeting deficiencies in required reserves in part resulting from increased loans. This readjustment in banking practice helped to retard the pace of bank credit and monetary expansion during 1946 and to lessen the creation of new inflationary pressures from this source.

Federal Reserve policy continued, as throughout the war, to be directed toward maintaining orderly conditions in the Government securities market and the general level of prices and yields of such securities. These policies facilitated the operation of the Treasury's vast financing program, helped to maintain the confidence of investors in the value of Government securities, and prevented unsettlement of the Government securities market such as followed the previous world war. Notwithstanding inflationary tendencies otherwise present, the prices of Government bonds continued substantially above their par values.

POSTWAR MONETARY POLICY

Authorities continue to be faced with the problem of adapting to peacetime requirements the monetary and fiscal structure inherited from wartime financing. In this, monetary policy will need to be closely related to the management of the public debt, and will require continued cooperation between the policies of the Treasury and the Federal Reserve.

Unless appropriate policies are devised to deal with the problems arising from an overly ample money supply, a vast public debt, extensive holdings of Government securities by the commercial banking system, and the existing structure of interest rates, the monetary and credit situation can be an unstabilizing element in the economy for many years. The Federal Reserve System will need to regain control over the volume of credit and to exercise some measure of flexibility in credit policy, while maintaining the low cost of debt service and continued stability in the Government security market.

Although developments in 1946 restrained the expansion in total bank credit and money supply and halted the decline in long-term interest rates that had resulted in the course of war finance, some of the conditions responsible for these tendencies continue to exist. Commercial bank holdings of Government securities at the end of 1946 were 50 billion dollars above prewar holdings. Over 40 billion of the bank holdings mature or are callable within five years. Commercial banks can readily obtain additional reserves by selling some of these securities to the Reserve System, which will have to purchase them if it wishes to maintain stability in the Government securities market. The assurance of stability in turn renders long-term securities the more attractive to bank investors. With a slowing down of the debt-retirement program and a decline of bank earnings in prospect, shifting into longer-term issues may be resumed in the future. Continued credit expansion and further downward pressure upon long-term rates of interest would result.

Under existing powers of the Federal Reserve System and with the necessity for maintaining stability in the market for the vast and widely distributed public debt, it is not possible for the Reserve System to maintain the same degree of control over the supply of bank reserves, and hence over potential credit expansion, that it formerly had. Certain measures of monetary regulation that can be adopted might exercise a degree of restraint, although they would not be sufficient to counteract strong tendencies toward inflationary or speculative credit expansion. Some of these measures are discussed in the following paragraphs.

Treasury refunding policies. To prevent further credit expansion at this time, the sale of Government securities to banks by nonbank holders should be discouraged. A shift of holdings from banks to other investors should be encouraged, so as to absorb available savings not attracted into private investment outlets. Much can be accomplished toward these ends through the selection of securities to be offered by the Treasury in its large-scale refunding of maturing issues during the years to come.

Securities offered to absorb the savings of the public should not be marketable issues of the conventional types. Long-term marketable issues, being subject to Federal Reserve support in case they should tend to decline in price, are in effect demand obligations bearing a higher rate of return than is customary for short-term securities. Because of the excess of long- over short-term rates, moreover, prices of long-term bonds rise for a period as they approach maturity; holders may, therefore, sell them before maturity at a premium and thus obtain an even higher return than that offered by the interest coupon.

Additional offerings of long-term marketable securities, even though initially ineligible for purchase by banks, would encourage some holders to sell existing issues of eligible securities to banks in order to purchase new issues. The resulting increase in available longer-term issues would again offer banks an opportunity to sell short-term securities to the Reserve Banks and to purchase longer issues, thus leading to creation of reserves and further multiple credit expansion. The refunding of short-term securities held by banks with marketable securities at existing long-term rates, therefore, would raise the interest cost of the Treasury without accomplishing the purpose of curtailing bank holdings or checking their expansion.

Such long-term bonds as need be issued to absorb the savings of the public not invested in private outlets should be in a nonmarketable form. They should be redeemable on demand prior to maturity at a discount so as to give a lower yield if not held until maturity, and sales should be limited to the amount of current savings or net additions to investment funds of the purchasers. These bonds would be similar to the present Series G savings bonds, with differences as to purchase limits and maturities. Through such an instrument an appropriate rate could be paid for genuine long-term savings, and the income of bona fide investors could be protected and their capital safeguarded against loss in case of necessary liquidation before maturity. Through these issues, the Treasury at the same time would be protected against having to pay a high coupon rate on highly liquid securities to purchasers who hold for a short period only.

Interest rates. In view of the large supply of Government securities of various types and issues outstanding and the possibility that banks may wish to increase their earnings, the tendency for banks to sell short-term securities to the Reserve System and purchase longer-term issues may recur at any time. The inducement for such shifts could be diminished by a narrowing of the margin between short-term and long-term rates on market issues of securities. If short-term rates are kept down, however, and such shifting in bank holdings does recur, rates on long-term marketable issues would tend to decline.

In view of the large public debt outstanding, it is desirable to maintain at the existing low levels the rate at which the Government can borrow on its long-term obligations. At the same time, it will be desirable to avoid further declines in rates which reflect the pressure of excessive bank credit expansion rather than a surplus of current savings over the capital demands of business. Further declines in long-term rates would reduce the return on savings invested in marketable issues and lower the incomes of endowed and savings institutions which depend on earnings from investments. This would seriously impair the functions of these institutions and lead to a weakening of our social and economic structure.

If the tendency for banks to shift from short-term to longer-term securities should be resumed, it could be discouraged by discontinuance of the Federal Reserve policy of purchasing short-term Government securities at present low rates. This would result in a rise in short-term interest rates and thus reduce the incentive for further monetization of the public debt. While it would continue to be necessary for the System to support Government securities and maintain an orderly market, the relationship between rates for various types of market issues might be permitted to become more responsive to demand and a greater degree of flexibility would be restored to control of credit through the money market.

New credit control powers needed. It should be recognized, however, that higher rates on short-term Government securities would not in themselves restore to the Federal Reserve System an adequate degree of control over the supply of bank credit. A readjustment of short-term rates and the introduction of some flexibility into rate policy would provide some check to further bank shifting and credit expansion, but it would not wholly solve the problem. As banks become accustomed to the higher level of short-term rates, and restricted longer-term issues become eligible for bank purchase in the market, a tendency to shift may reappear.

More important, an increase in short-term rates would not prevent the shifting by banks from holdings of Government securities to private loans or corporate securities, if attractive loans or investments were available. On the basis of such shifts the banking system would be in a position to create reserves and to engage in uncontrolled credit expansion. Under existing Federal Reserve powers there is no assurance that such a development could be prevented except by permitting interest rates to rise to a point that would unstabilize and perhaps demoralize the entire Government securities market.

Effective regulation of bank credit expansion in the future can be assured only by providing for a more direct way of decreasing the ability of banks to shift at will their holdings of Government securities to the Reserve System and thus to engage in excessive credit expansion. An attempt to restrict credit through sale by the System of securities in the open market or even by limiting the System's purchases might cause sharp declines in prices of

Government securities which could not be tolerated and which might fail to accomplish the desired purpose. In Canada and England monetization of the public debt by banks is limited by well-established banking traditions, and by informal understanding between the authorities and the relatively small number of banks operating in those countries. These arrangements are not possible in this country with its 14,000 independent commercial banks.

If, in the changed postwar situation, the Reserve System is to be able to perform the function for which it was established, namely, to adjust the supply of bank credit and money to the needs of the economy, and, especially, to prevent undue credit expansion in periods of inflation, additional powers will be required. In its 1945 *Annual Report* the Board proposed for consideration by the Congress various measures which, if adopted, singly or in combination, would give the Reserve System a more effective degree of control over bank credit and over the level of interest rates. The problems then presented will continue for many years. Action along these lines will be needed to rehabilitate the traditional instruments of Federal Reserve policy—open-market operations, discount rates, and reserve requirments—and to assure a reasonable degree of financial stability in the future.

LEGISLATIVE PROPOSALS

Purchase of Government securities directly from Treasury. Under existing law the Federal Reserve Banks have temporary authority to purchase Government securities directly from the United States, subject to the limitation that the amount of securities so purchased and held by them at one time shall not exceed 5 billion dollars. There was practically no limitation on such purchases until they were prohibited by the Banking Act of 1935. Large-scale Treasury operations during the war led to the modification of that restriction under the War Powers Act, which expired on March 31, 1947. The Board, with the concurrence of the Treasury Department, recommended to the Congress that this authority be extended, and a bill granting a three-year extension was signed by the President on April 28, 1947.

While not used extensively, the authority has proved a useful means of facilitating Treasury operations and of effecting temporary adjustments in the money market. It has provided the Treasury with a line of credit to which it may turn to obtain funds to meet temporary contingencies, ordinarily around tax payment dates, and has made it possible for the Treasury to operate with a smaller cash balance than might otherwise have been necessary, thus effecting savings in the cost of carrying the public debt.

Consumer credit regulation. In its 1945 *Annual Report,* the Board recommended that Congress give consideration to legislation which would authorize the Federal Reserve System to continue regulation of consumer credit. The use of consumer credit has been increasing rapidly since V-J Day, notwithstanding the restraint imposed by the Board's Regulation W, and is likely to increase more rapidly in the future as more consumers' durable goods become available, as wartime savings are drawn down, and as instalment sellers, sales finance companies, banks, and other credit-granting institutions increase their competitive efforts to expand their business. The Economic Report of the President to the Congress on January 8, 1947, stated that "undue expansion of deficit financing on the part of millions of American families can gravely hurt our business system."

The experience of this country over the quarter century before the war suggests that increased use of consumer credit, particularly instalment credit, to finance the purchase of durable goods, may be needed to sustain long-term economic growth. This experience also shows, however, that over-expansion and subsequent severe contraction of consumer credit can have highly unstabilizing effects on the national economy.

Excessive fluctuations in consumer credit could be restrained by regulation, flexibly administered, such as the Board has maintained since 1941 on the basis of a wartime Executive Order. The Board does not feel, however, that the authority should be continued on this basis beyond the time required for appropriate legislative review and determination by the Congress as to whether the consumer credit problem should have specific legislation.

Regulation of this type is particularly appropriate at the present time when the supply of money is already excessive in relation to the available volume of goods. It can restrain excessive demands for credit by limiting the borrowing capacity of prospective purchasers of goods without operating, as general instruments of credit policy must do, by increasing the cost of credit to the Government or to industry.

In present circumstances producers and distributors of consumers' durable goods have a broad and active market, at prevailing prices. In course of time, however, as production catches up with deferred demand, they will need to take steps to broaden the market. In the long run, the sound and tested method of free enterprise would be to find ways of gradually lowering prevailing prices. That is the direction which competition should take, and will sooner or later have to take. To stave it off by attempting to maintain prevailing prices through the competitive granting of easier and easier credit terms might work for a short time, but only at the cost of eventual convulsive readjustment. Continuance of consumer credit regulation of the type now in effect can do much, both now and later on, to prevent competition from taking that economically unsound direction.

Reserve Bank guarantee of loans to business. In order that there may be a means of prompt financial assistance to small- and medium-size business enterprises whenever the need occurs, the Federal Reserve Banks should have authority to guarantee in part business loans made through established banking channels. Accordingly, the Board has recommended to the Congress that such authority be provided. Under the proposal the Reserve Banks would guarantee business loans made by chartered banks. Guarantees would be subject to a fee charge which would increase with the guarantee percentage. The maximum guarantee would be 90 per cent. A major purpose of the recommendation is to strengthen and make more effective existing facilities for financing small enterprises, and particularly to assure an adequate and continuing availability of long-term loans to these businesses.

In proposing the legislation to provide this authority, the Board has also recommended repeal of Section 13b of the Federal Reserve Act, adopted in 1934, which empowers the Federal Reserve Banks to make and to guarantee industrial loans. Certain provisions of this section have proved so restrictive as seriously to impair the ability of the Reserve Banks to lend directly to business or to assist banks and other lenders in such lending. In lieu of Section 13b, the Board has recommended that a paragraph be added to Section 13 of the Federal Reserve Act authorizing the Federal Reserve Banks to guarantee loans made by chartered banking institutions to business enterprises on a much more effective basis than that permitted by present law.

By the repeal of Section 13b, the Federal Reserve Banks would be required to return funds heretofore advanced to them by the Treasury to help support their industrial loan activities. The appropriation of about 139 million dollars available under existing law for industrial loan operations of the Reserve Banks would be repealed and Government appropriations would no longer be used for this purpose. A bill containing these provisions was introduced in Congress early in 1947.

This legislation, which would be strictly permissive, would not place the Reserve Banks in competition with the private banking system. Loans guaranteed would originate with local banks dealing with local people whom they know and with whose character, capability, and capacity they are familiar. No loan would be considered for guarantee except on request of the lender prior to extension of credit, and the Reserve Bank to which the guarantee request was made would have full responsibility for acting on it. The twelve Federal Reserve Banks and their twenty-four branches afford a regional organization through which established banks in all areas of the country would have convenient access to a guaranteeing agency.

The principal purpose of the legislation would be to make term loans, especially to smaller businesses, for the purpose of providing them with necessary capital that they could not otherwise obtain. It would fill a gap in private financing that now exists by enabling these enterprises to obtain essential financing. The costs of going to the capital markets for small business are prohibitive. Also, many banks properly feel that they cannot extend some term credits without a degree of protection. The bill provides for a way of spreading the risk through insurance for a fee. It is not the purpose of the bill to provide guarantees for either short- or long-term financing which banks can and should extend without assistance.

The basic need of the smaller, independently owned business enterprises is for long-term funds. Some businesses need funds for modernization of plant and equipment and additional facilities. The need also arises from the sharp increase in prices and greatly expanded volume of business resulting in a much larger volume of accounts receivable and of inventories. Because of these various factors many enterprises whose financing needs have ordinarily been met through current borrowings now need a funding of their short-term obligations into a term loan.

Owners of small enterprises, as a rule, prefer to obtain funds on a loan rather than on an equity basis because they do not wish their stock ownership to be diluted or to run the risk of losing control of the business. Term loans amortized out of profits meet this need. This type of financing is particularly suitable for small businesses that can retire loans only gradually.

The proposed guarantee procedure established by the Federal Reserve Banks would be subject to general regulations prescribed by the Board and to several statutory limitations. No guaranteed loan could have a maturity of more than 10 years. The guarantee would not exceed 90 per cent of any loan. The aggregate amount of all guarantees would not exceed the combined surplus of the twelve Federal Reserve Banks. The total amount of all guarantees which are individually in excess of $100,000 would not be permitted to exceed 50 per cent of the combined surplus of the Reserve Banks.

Authorization of the Reserve Banks to guarantee business loans in part would apply tested principles and procedures. Even under the restricted powers granted in 1934, the Reserve Banks have approved 3,542 applications amounting to a total of nearly 570 million dollars. For the System as a whole the interest and fees collected have exceeded expenses and losses. During the war, the Reserve Banks acquired further loan guarantee experience in their administration as fiscal agents of the War Department, Navy Department, and United States Maritime Commission of the V-loan program for guaranteeing war production loans. They processed authorizations for 8,771 of such loans, aggregating 10.5 billion dollars. Guarantee fees collected by the Reserve Banks far exceeded their expenses and the losses sustained by the guarantors.

Limitation on Federal Reserve branch buildings. As the result of the tremendous increase in the operations of the Federal Reserve Banks and their branches, especially in their fiscal agency operations for the Treasury Department and other Government agencies, the building facilities of many of the branches of the Federal Reserve Banks have become inadequate for the effective performance of their functions. Consequently, the Board has recommended legislation which would permit necessary construction of Federal Reserve Bank branch buildings, exclusive of vaults, machinery, etc. The cost would be met entirely from Federal Reserve Bank resources.

Bank holding company legislation. The need for new legislation to provide more effective supervision and control of bank holding companies and to curb abuses in that field continues to be a matter of serious concern to the Board. As pointed out in the Board's *Annual Report* for 1943, Congress attempted to deal with this matter in the Banking Act of 1933, but experience has demonstrated that the existing law is clearly inadequate to accomplish its purposes. To correct this situation, the Board has recommended legislation which would treat bank holding companies in much the same manner as banks themselves and would include provisions regulating expansion and requiring the divorce of activities unrelated to banking. Bills designed to carry out the Board's recommendations were introduced in Congress in 1945 and 1946, but no action was taken. The abuses described in the Board's 1943 Report continue and the urgent need for legislation still exists.

Capital requirements for member banks. The Board has recommended repeatedly the enactment of legislation which, particularly so far as capital requirements are concerned, would eliminate existing discriminations against national and State member banks with respect to the operation of branches and in this regard place them on a comparable basis with State nonmember banks. The Board continues to feel that such legislation is necessary. The laws of many States permit State banks to operate branches with much less capital than that required of national and State member banks under Federal law. This results in unfair discrimination against member banks and, in effect and without justification, closes the door in many instances to membership of sound banks in the Federal Reserve System. There are also other provisions of the law with respect to capital requirements for membership in the System which prevent State banks, that otherwise would be entitled to the privilege, from becoming members, and the Board believes consideration should be given by the Congress to changes in these provisions.

GOVERNMENT FINANCE IN TRANSITION

Following drastic reduction of Federal Government expenditures during the second half of 1945, the decline during 1946 was at a much slower rate. Budget expenditures, which reached a wartime peak of 27 billion dollars in the second quarter of 1945, fell to 12 billion dollars by the first quarter of 1946, and amounted to 9 billion in the last quarter. Notwithstanding lowered individual income tax rates in 1946, receipts remained large, reflecting the continued high level of national income.

For the year as a whole, as shown in the accompanying table, budget expenditures were only slightly larger than budget receipts, compared with a deficit of 44 billion dollars in 1945. The large cash balance, built up to 26

BUDGET EXPENDITURES AND RECEIPTS AND CHANGES IN PUBLIC DEBT
[In billions of dollars, for calendar years]

	1946	1945
Expenditures[1]	45.1	89.8
Net receipts	41.6	46.0
Budget deficit	3.5	43.7
Change in general fund balance	−22.5	+ 3.8
Change in gross public debt: total	−19.0	+47.5

[1] Including net expenditures of trust accounts, etc.

billion dollars during the Victory Loan Drive, was drawn upon to retire outstanding public debt, which was reduced by 19 billion dollars during 1946.

The publicly-held marketable debt decreased by 22 billion dollars in 1946 and savings notes outstanding by 2.5 billion. Savings bonds, on the other hand, increased by 1.6 billion dollars; Series F and G bonds continued to increase, while redemptions of Series E bonds, although declining from the high rate at the beginning of the year, continued to exceed sales. Special Treasury issues to Government trust accounts and to members of the Armed Forces (leave bonds) increased by more than 5 billion dollars.

The total public debt continued to increase somewhat in the first two months of the year, reaching a peak of 280 billion dollars at the end of February, and then was reduced to 259 billion at the end of the year. From the beginning of the debt-retirement program on March 1 to the end of the year, marketable public debt was reduced by 23 billion dollars. Maturing bonds amounting to 2 billion dollars and about half of the 13 billion of maturing notes were paid off in cash, as were somewhat over 14 billion dollars out of 38 billion of maturing certificates. The remaining notes and certificates retired were replaced by new certificate issues. At the end of 1946 the total amount of certificates and notes outstanding was smaller than at any time since early 1944, but owing to the amount of bonds approaching maturity, the total volume of outstanding issues maturing within one year continued relatively large.

The debt-retirement program was the major factor bringing about changes in the ownership of marketable debt throughout the year, but there were also some shifts through market purchases and sales. By far the largest reduction in holdings of Government securities occurred in the case of commer-

CHANGES IN OWNERSHIP OF UNITED STATES GOVERNMENT SECURITIES DURING 1946

[Partly estimated; par value, in billions of dollars]

Type of issue	Total outstanding	U.S.Gov't agencies and trust funds	Federal Reserve Banks	Commercial banks[1]	Mutual savings banks	Insurance companies	Indiv's, corp's, and others
Marketable public issues: total	**−22.2**	**−0.7**	**−0.9**	**−15.9**	**+1.1**	**+0.9**	**−6.7**
Treasury bills			+1.9	−1.3			−0.6
Certificates	−8.2		−0.9	−6.9	+0.2	+0.1	−0.7
Treasury notes	−12.9		−1.8	−9.6			−1.5
Treasury bonds: total	*−1.1*	*−0.7*	*−0.2*	*+1.9*	*+0.8*	*+0.8*	*−3.7*
Due or callable—							
Within 5 years	+9.7			+7.3	+0.4	+0.6	+1.4
5 to 10 years	−5.7	−0.3	−0.1	−4.4		−0.1	−0.8
10 to 20 years	−2.6	+0.2		−1.3	−0.2	+0.6	−1.9
Over 20 years	−2.4	−0.7		+0.2	+0.6	−0.3	−2.2
Nonmarketable public issues: total	**−0.5**			**−0.1**			**−0.4**
Savings bonds[2]	+1.6						+1.6
Savings notes	−2.5						−2.5
Other	+0.5			−0.1			+0.6
Special issues	**+4.6**	**+4.6**					
Total interest-bearing securities[3]	**−18.3**	**+3.9**	**−0.9**	**−16.0**	**+1.1**	**+0.9**	**−7.3**

[1] Includes holdings by commercial banks covered in the Treasury Survey of Ownership of Government securities.
[2] Series A-D, E, and F savings bonds included at current redemption values.
[3] Total includes guaranteed securities not included in preceding groups.

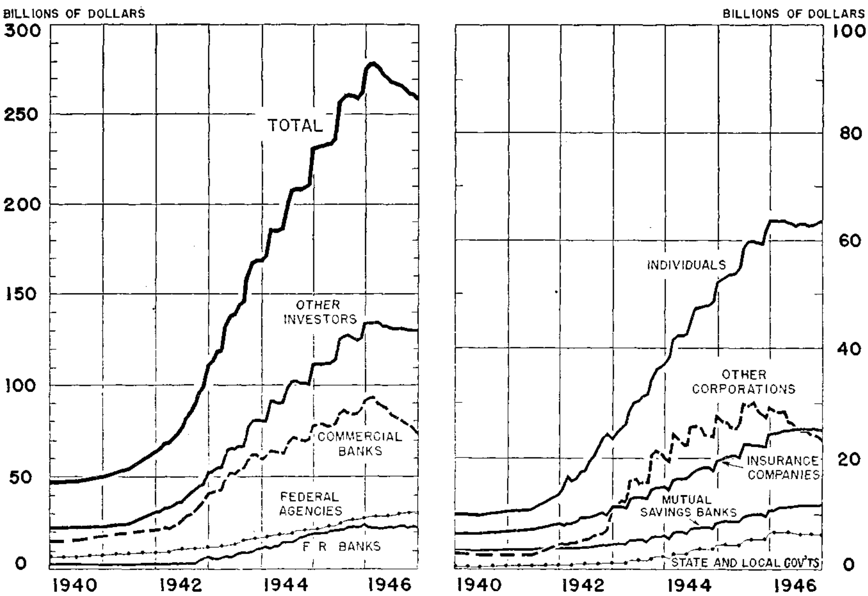
NOTE: Detailed figures may not add to totals because of rounding.

cial banks, which held about half of the issues retired. As shown in the table, commercial bank holdings declined by 16 billion dollars. This reflected retirement of about 12 billion and sales of about 4 billion. The sales were mostly to the Reserve Banks to replace reserves absorbed by retirement of Reserve Bank holdings. As a result there was little net change in the System's portfolio, although 4.5 billion dollars of its holdings were retired.

Other groups, which received nearly 7 billion dollars for retired issues, repurchased about 2.5 billion of Government securities in the market. Individuals and corporations, however, sold long-term issues (mostly acquired in war loan drives) to institutional investors and apparently increased their holdings of short-term issues, after allowance for retirements.

The reduction in United States Government security holdings by commercial banks was mostly in Treasury certificates and notes. Notwithstanding the loss of reserve funds under the retirement program, bank investment in bonds continued in moderate amount and was made possible on the basis of reserves gained from the sale of short-term issues to the Federal Reserve Banks and from other sources. The expansion of bond holdings was considerably less, however, than during earlier years when current financing made available a rapidly growing supply of long-term bonds and nonbank investors sold existing issues to commercial banks in order to buy new issues. Reduction in bank holdings of short-term issues during 1946 lengthened

OWNERSHIP OF U. S. GOVERNMENT SECURITIES



NOTE: All data are end-of-month figures, for June and December, 1939-41; monthly thereafter. The groups shown on the right-hand side of the chart are the components of the "Other investors" group shown on the left-hand side.

the average maturity distribution of bank holdings somewhat, more than offsetting the effects of passing time in shortening the average maturity. By maturity groups, the largest increase in holdings occurred in the 1-5-year class although there was also some increase in maturities over 20 years.

Changes in the ownership of total interest-bearing United States Government securities—marketable plus nonmarketable—are shown in the chart. The reduction in holdings of marketable debt was offset, to a small extent, by increased holdings of nonmarketable issues. Holdings of special issues by Government agencies and trust funds continued to increase; savings bonds, held largely by individuals, also increased further, while tax and savings notes, held principally by corporations, declined.

MONEY RATES AND BOND YIELDS

Increased pressure on bank reserves and the lengthened average maturity of bank portfolios resulting from debt retirement, together with elimination of the preferential discount rate, contributed to a slight firming of rates in the money market. It was not possible for rates to rise much since the Federal Reserve System continued to purchase and sell Treasury bills at ⅜ per cent and to support the certificate rate at ⅞ per cent. Under this policy, the large holdings of short-term securities by the banking system provided the basis for an almost unlimited supply of low-cost bank credit altogether at the discretion of individual banks.

By early May all of the Reserve Banks had discontinued the preferential discount rate on advances to member banks secured by Government obligations maturing or callable within one year.[1] Following elimination of this special rate of ½ per cent, which had been put into effect during October 1942, the discount rate of one per cent became applicable to advances secured by all maturities of Government obligations. In July following this action several large commercial banks raised their charges on loans secured by Treasury certificates of indebtedness from ⅞ to one per cent and on those secured by longer-term Treasury issues from ¾ to one per cent. Also, the rate on brokers' borrowings was advanced from 1 to 1½ per cent.

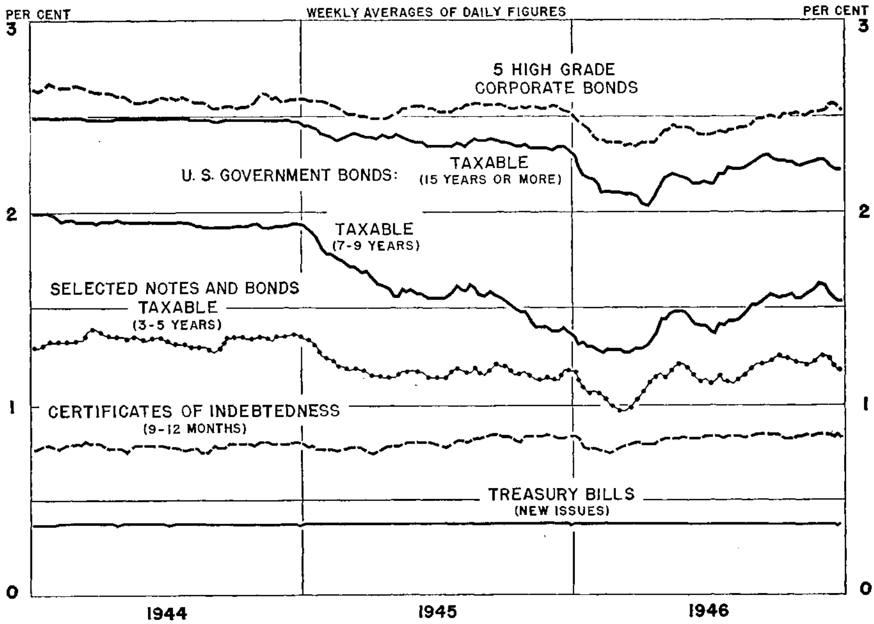
During April and May 1946, the open market rate on 90-day bankers' acceptances in New York City was increased from 7/16 to ½ per cent, that is, to the buying rate of the Federal Reserve Bank. In view of the increase in other short-term rates, however, bankers' acceptances became practically unsalable in the market, so that in July an upward adjustment to ¾ per cent was made in the Federal Reserve buying rate for bankers' acceptances matur-

[1] The preferential discount rate of one per cent on advances to nonmember banks secured by direct obligations of the United States was eliminated at all Reserve Banks by the end of April. The discount rates at each Federal Reserve Bank on Dec. 31, 1946, are shown in Table 10, p. 84.

ing within three months. This action was followed by further advances in the buying and selling rates of acceptance dealers, and in August by an increase to one per cent in the minimum buying rate offered by the Reserve Bank. There were also slight increases in open market rates on commerical paper and stock exchange call and time loans.

Bank rates to commercial borrowers have generally averaged slightly below those for earlier years. Short-term rates in 19 principal cities averaged 2.34 per cent for the four quarterly report periods in 1946, or about the same level as in 1945 and slightly under the level obtaining in 1944.

YIELDS ON TREASURY AND CORPORATE SECURITIES

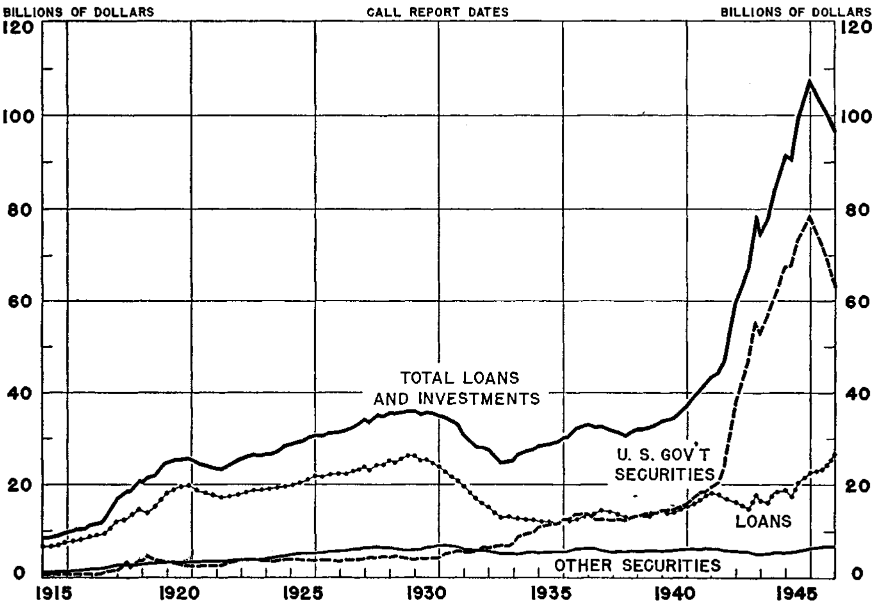


Yields on long-term Treasury securities declined sharply in the early part of the year, when the yield on the longest outstanding issue dropped from 2.46 per cent to 2.12 per cent. For the remainder of the year there was a slight upward trend in yields and at the end of the year the longest-term issue had returned to 2.32 per cent. Long-term yields were nevertheless lower than for any period before 1946. Yields on medium-term issues showed similar fluctuations. High-grade corporate security yields also declined in the early part of the year, as shown in the chart. However, by the end of the year they had regained their initial level and the spread between corporate and long-term Treasury bond yields widened.

BANK CREDIT DURING RECONVERSION

Banking and credit developments during 1946 continued to be greatly influenced by Government financing, but expansion of private credit at banks again became important and was greater than for any year since 1919. Bank reserves were under some pressure because of Treasury retirement of Government securities held by Federal Reserve Banks, because of transfers of deposits from Government to private accounts accompanying Treasury retirement of publicly held debt, and because of loan expansion associated with the rising level of production and consumption and advancing prices. The trend of commercial bank loans and investments during the past 30 years is shown on the chart.

LOANS AND INVESTMENTS OF MEMBER BANKS



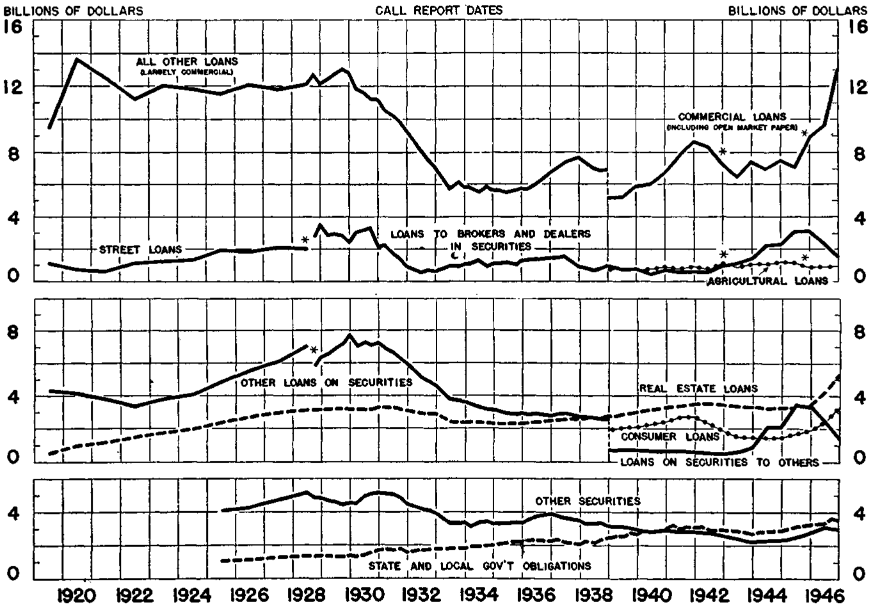
The withdrawal by the Treasury of nearly 22 billion dollars of war loan deposits caused no reduction in member bank required reserves, as no reserves have been required against these deposits since early in the war. The further growth in other deposits, however, did increase required reserves of member banks by over a billion dollars during the year. These needs were partly met by a reduction in excess reserves, which were temporarily large a year earlier, so that the growth in total reserves was limited to about 500 million dollars. Losses of reserves due to Treasury retirement of securities held by Reserve Banks were about offset by Reserve System purchases of securities in the market. Under existing Federal Reserve policies, as previously pointed out, potential credit expansion is limited only by the available supply of suitable loan and investment assets.

Reduction in Government security holdings. Retirement of public debt by drawing on accumulated Treasury balances, discussed earlier, caused a sharp decline in commercial bank holdings of Government securities, particularly of short-term issues, from the extremely high level reached at the end of 1945. In addition to securities redeemed, banks sold short-term securities from their portfolios in order to maintain their reserve positions and to expand loans. Some purchases were made of medium- and long-term issues, but in much smaller amounts than during the war years.

Expansion in bank loans. Bank lending to businesses and individuals became increasingly important during 1946. As shown in the chart, many types of loans at member banks increased to new high levels. There was a sharp advance in loans to business concerns, to real estate owners, particularly of urban property, and to consumers. Bank loans for purchasing or carrying securities, however, declined from the high level prevailing early in the year; the reduction of loans secured by Government obligations was particularly large. Relatively little change occurred in loans to finance farm production.

CLASSIFICATION OF MEMBER BANK LOANS AND INVESTMENTS

OTHER THAN U. S. GOVERNMENT SECURITIES



* Indicates change in series.

NOTE: Figures are partly estimated for street loans, 1925 to 1928, and for all classifications prior to 1925. Street loans include loans made by member banks to New York City brokers and dealers in securities. Commercial loans include commercial and industrial loans, open market commercial paper, and acceptances.

Comparability of both commercial and agricultural loans is affected somewhat by changes in reporting in December 1942 and again in December 1945. Consumer loans are partly estimated prior to Dec. 31, 1942.

More than half of the expansion in private credit at banks in 1946 resulted from loans to businesses. Total business loans outstanding at all member banks, other than those secured by real estate, increased more than 4 billion dollars during the year. The increase reflected borrowings by business of all sizes at banks in all parts of the country. Loans expanded moderately until mid-year and at an exceptionally rapid rate from then until close to the year end.

Increased business borrowing at banks resulted to some extent from the general expansion in operations which required additional plant and equipment as well as larger inventories and extension of credits to customers. Expenditures on plant and equipment increased sharply; the total for the year as a whole was about 80 per cent above that of 1945 and about one-third above that of 1929. At times during the year, especially in the early months, bank credit was used temporarily to finance fixed expenditures while long-term financing through security issues was being arranged.

The accumulation of an unprecedented volume of inventories and receivables at rapidly rising prices during the last half of the year necessitated, to a considerable extent, the marked expansion in bank credit in that period. The dollar expansion of inventories by manufacturing and trade concerns in 1946 was almost 50 per cent greater than the large increase in 1941, and the indications are that customer receivables also increased by a record amount.

It became clear in 1946 that the exceptional volume of liquid assets—bank deposits, currency, and United States Government securities—accumulated by business during the war would not act as a damper on external financing. Despite these holdings and an unusually large volume of retained earnings, the volume of new funds obtained through bank loans and security issues exceeded that of any year since the late 1920's. Aggregate liquid assets of businesses were reduced moderately, and the major part of the reduction was in holdings of Government securities. In some cases, as would be expected, such assets were not held by the individual businesses that were most acutely in need of funds. Other firms apparently planned to retain the increased liquidity acquired during the war years, even at the cost of obtaining credit, until postwar demands for products and opportunities for profitable investment were more clearly discernible.

Late in the year, the Federal Reserve System conducted a national survey of member bank loans to commercial and industrial businesses. Member banks as a whole were found to have some 672,000 of such loans outstanding, aggregating over 13 billion dollars. Loans to medium and small concerns accounted for the bulk of the loans in number and for over one-third of the total amount. Dollar volume was heaviest among large manufacturing and mining corporations while numerical importance was greatest among small retail stores. Enterprises in all principal industries were included among the borrowers. A particularly noteworthy finding was that more than one-third of the business loans outstanding were term loans having maturities of more than one year and that these loans were a significant source of funds for medium and small concerns as well as for large business corporations. At large banks the major portion of the loans were to businesses engaged in manufacturing and mining, with substantial amounts to wholesalers and public utilities, while at small banks retailers made up the largest group of business borrowers. Small business units did the bulk of their borrowing from medium-size and small banks.

Bank loans to consumers reflected the recovery of expenditures for durable items and the rise in prices of these goods. Consumer credit and its regulation are discussed in other sections of this report.

Expansion of real estate loans has reflected particularly the strong postwar demand for housing and the consequent inflation of real estate activity and prices. These conditions produced a larger number of mortgages available for purchase, and commercial banks apparently increased their share of mortgage holdings relative to other lenders. A large portion of the new loans were in part guaranteed by the Federal Government under the Servicemen's Readjustment Act.

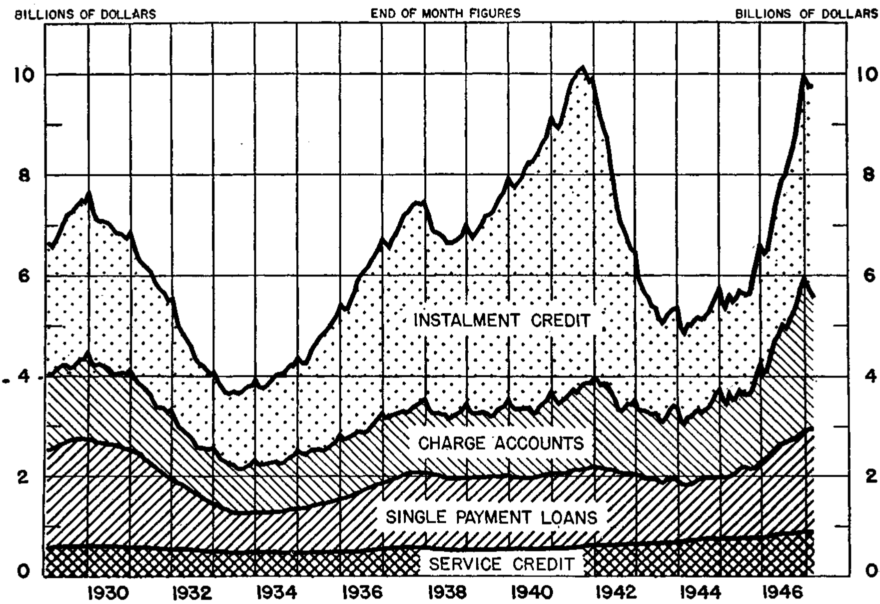
Rapid expansion in bank loans for business, real estate ownership, and consumption purposes was offset in part by a reduction of about 3.5 billion dollars in loans to brokers and dealers and to others for purchasing and carrying securities. Such loans, after reaching a peak at the end of 1945 during the Victory Loan Drive, declined rapidly and almost without interruption. The decline reflected primarily the reduction in loans on Government securities but also some decline in loans on other securities. At the end of 1946 member bank loans for purchasing or carrying securities amounted to 3 billion dollars as compared with 6.5 billion at the end of 1945 and somewhat over one billion at the end of 1941. As pointed out in a later section of this report, loans for purchasing or carrying stocks declined in 1946 to the lowest level in many years.

CONSUMER CREDIT

During 1946, as in the late months of 1945, consumer credit increased rapidly. The total amount outstanding increased during the year by more than 3 billion dollars, or by about 50 per cent. This was a much greater expansion than had taken place in any prewar year and an annual rate of growth without recent precedent. Consumers' goods were again coming on the market in quantity, at prices much higher than before the war, consumers were eager to buy them and in a position to go into debt for the purpose, and both merchants and financial institutions were active in promoting credit extension. Changes in the various components of consumer credit over the past 18 years are shown by the chart on page 20. Although the total amount of consumer credit outstanding at the end of 1946 approached the prewar high, it was still low in relation to the level of national income and this was particularly true of instalment credit.

The large increase in consumer indebtedness during the year had been foreshadowed by the findings with respect to consumer intentions that were brought out by a survey early in the year of liquid assets held by the public, referred to elsewhere. People were intending, it was found, to make extensive use of credit if they could get goods they wanted, notwithstanding their having in hand cash and other liquid assets in unprecedented amounts.

CONSUMER CREDIT OUTSTANDING



Large as the year's increase turned out to be, it would have been larger—and more inflationary—except for the continued restraining influence of the Board's consumer credit regulation, Regulation W. The principal methods of restraint applied by the regulation are requirements (1) that a substantial down payment, usually one-third, shall be obtained on instalment sales of specified consumers' durables, such as automobiles and household appliances, and (2) that the length of instalment contracts, whether arising from instalment sales or instalment loans, shall not exceed a certain number of months, such as 12 or 15 or 18 months. Under this regulation, the typical maximum maturity permissible throughout most of the year 1946 was 15 months. For certain loans 18 months was permissible during the first two-thirds of the year, and for instalment sales, except in the case of automobiles, the permissible maturity was 12 months until this was changed to 15 toward the end of the year.

Effective December 1, 1946, for peacetime administrative reasons, the Board made an extensive revision of Regulation W. This was the first general revision since May 6, 1942, when the regulation had been expanded to cover noninstalment forms of consumer credit—charge accounts and single-payment loans—and to prescribe terms for a much longer list of consumers' goods, including many minor durables and semidurables. By the 1946 revision the regulation was again confined to instalment financing, the list of consumers' goods was cut down to major durables, including automobiles, household appliances, and a few other items, and numerous simplifying changes were made in the supporting rules. After the general revision, the regulation no longer covered the whole field of consumer credit but it continued to apply to that large part of the field which is subject to the widest range of expansion and contraction and is accordingly of most consequence as a strategic factor of business stability or instability.

In announcing this revision, the Board stated that the basic terms of the regulation would need to be modified in accordance with the course of economic events, and repeated the earlier recommendation that Congress consider legislation for the permanent regulation of consumer credit.

STOCK MARKET CREDIT

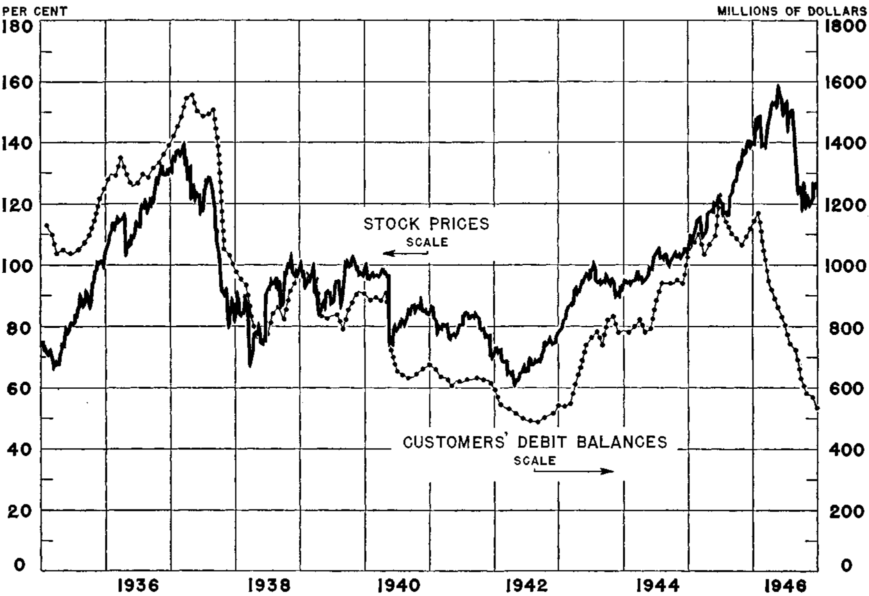
In January 1946 the Board's regulations governing margin requirements were tightened to require full cash payment for listed stocks, following an increase in margin requirements to 75 per cent of market value in July 1945. Owing in part to the influence of these restrictions, and to a tapering off and recession in stock prices, stock market credit declined sharply during 1946 by 600 million dollars. As shown by the chart, the amount owed by customers to members of the New York Stock Exchange at the end of the year was at about the lowest level reached in many years.

The rise in stock prices, which had continued without marked interruption since the spring of 1942, tapered off in the summer of 1946 and was followed by a decline of about 25 per cent from peak levels. Average prices fluctuated within a narrow range during the last three months of the year and at the end were about 10 per cent lower than at the beginning of the year.

The high margin requirements no doubt prevented an increase in the use of stock market credit, which has ordinarily in the past accompanied rising prices. They thus helped to limit the extent of the price rise early in the year and also to remove the pressure of forced liquidation in the decline, thereby contributing to greater long-run stability in the stock market and the general economy. The decline in credit offset to some extent the inflationary pressures present in other fields.

In view of the fact that stock market conditions, as well as general economic prospects, had altered materially by early 1947, the Board on January 17 amended its regulations on margin requirements, effective February 1, to permit credit on the basis of 75 per cent margins. This action, which made the requirements slightly less restrictive than they had been in 1946, was taken in recognition of the apparent abatement of many of the inflationary forces that had operated during that year.

STOCK MARKET



Since the end of the war, stock market credit has declined to a level lower in relation to stock prices than at any time for which data are available. Such a change in this relationship is consistent with the new and unprecedented economic situation which has developed out of the war, particularly the large amount of liquid assets held by people who engage in stock market operations.

SLACKENED GROWTH IN LIQUID ASSETS

Growth in liquid asset holdings was considerably retarded in 1946 compared with the rapid wartime rate of expansion. This retardation reflected the diminished margin between incomes of individuals and their current expenditures, the growth in capital expenditures, and the sharp reduction in the Federal Government deficit. Total liquid assets—bank deposits, currency, and United States Government securities—amounted to an estimated 225 billion dollars as of December 31, 1946, as compared with 221 billion a year earlier. Bank deposits, both demand and time, continued to increase although at a reduced rate, particularly time deposits. Currency holdings increased only slightly, compared with an average annual growth of somewhat more than 4 billion dollars during the war years. Although most of the public debt retirement came from holdings of banks, a part of it was from business and individual holdings, and businesses also used a part of their savings notes to meet tax liabilities.

Changes in deposits. Deposits held by individuals and businesses at all banks increased by about 13 billion dollars in 1946. This growth was almost as large as the average for the war period and added substantially to the inflationary pressures. During 1945 and other war years, the expansion in liquid assets had resulted from financing the war in substantial part through the sale of Government securities to banks, and the large and relatively inactive deposit balances many businesses and individuals accumulated. In contrast, during 1946 the retirement of Government securities held by nonbank investors and a revival in private demand for bank credit were the dominant factors in sustaining expansion of the public's deposits. These changes are shown in the table below.

FACTORS IN POSTWAR EXPANSION OF DEPOSITS AND CURRENCY HOLDINGS OF INDIVIDUALS AND BUSINESSES
[Figures partly estimated, in billions of dollars]

	1946	1945
Expansive factors:		
Decrease in U. S. Government deposits	21.5	....
Increase in bank holdings of U. S. Government securities	....	20.8
Increase in bank holdings of other securities	0.9	1.0
Increase in bank loans	5.3	4.3
Net of other factors	0.8	....
Total factors increasing deposits	**28.5**	**26.1**
Contractive factors:		
Increase in U. S. Government deposits	....	3.8
Decrease in bank holdings of U. S. Government securities	15.6	....
Net of other factors	....	2.3
Total factors contracting deposits	**15.6**	**6.1**
Increase in deposits and currency—total	**12.9**	**20.0**
Demand deposits adjusted	7.5	8.9
Time deposits	5.2	8.1
Currency outside banks	0.2	3.0

NOTE: Figures cover all commercial banks, mutual savings banks, and Federal Reserve Banks; interbank items are excluded.

In 1946 the growth of demand deposits of individuals and businesses was almost as large as the average for the last two war years. The growth of time deposits, which were used widely in late war years as media for individual savings, slackened considerably in the latter half of 1946, especially in the last quarter.

During the first half of 1946 the increase in demand deposits of individuals and businesses was distributed broadly among the balances of all major groups of holders. This is in contrast both with late war years, when virtually all of the demand deposit growth occurred in accounts of individuals and trade and service concerns, and with the reconversion period in the last half of 1945 when balances of manufacturers fell off sharply.

In 1946 all regions showed increases in deposits of individuals and businesses close to the average for the country as a whole, whereas during the war deposits had expanded more rapidly in the South and West than in other areas. The wartime shift of funds resulted largely because in these two areas the Government was spending much more money than it was raising from taxes and the sale of securities. This development reflected the concentration of special military camps and depots and the relatively greater expansion of industrial facilities in these areas, together with the very substantial rise in prices of farm products. In 1946 two of these factors became less important. Government expenditures declined, and shifts in funds out of the money centers resulting from current Treasury budget operations may have been offset in part by some return of funds as a consequence of Treasury debt retirement. The further rise in agricultural prices toward the end of the year, however, appears to have moderated considerably any tendency in recent months for funds to shift to the North and East as a consequence of the increasing production and sale of manufactured goods.

Currency. Currency in circulation, which had expanded rapidly throughout the war period, increased only slightly in 1946. After a substantial post-Christmas decline its volume changed little until the latter part of May. In the summer and fall, however, expansion was somewhat more than the usual seasonal amount and at the end of 1946 circulation was about 500 million greater than at the end of the previous year. An increase of this amount is not large in view of the sharp rise in the volume of private transactions during the year. The increase occurred in bills of $20, $50, and $100 denominations, while bills of small and of very large denominations declined. These shifts reflect in part the effect of higher prices and income and perhaps in part the use of moderately large denomination currency to hold idle funds or for tax evasion and other illegal transactions. The shift from very large denominations reflects the influence of increased vigilance in reporting and investigating large currency transactions.

Printing of Federal Reserve notes in denominations of $500 and over was discontinued during 1946, but notes of these denominations will continue to be paid out by the Federal Reserve Banks to member banks as long as present stocks last.

Ownership and uses of liquid assets. A survey of liquid asset holdings of individuals conducted for the Board in January 1946 showed that a relatively small portion of the owners held a relatively large portion of the assets, but that in all probability the distribution was much broader than had characterized the prewar period. This result was apparently to be accounted for by the rapid growth of income among low-income groups during wartime. Liquid asset holdings were widely distributed among the various income groups, consumers with annual incomes below $5,000 holding nearly two-thirds of all liquid assets, other than currency, held by individuals. The survey also showed that most consumers regarded their liquid assets as permanent or rainy-day reserves, not to be disposed of in capricious or improvident spending. At the same time the amounts they intended to spend in 1946, although a small portion of total holdings, were significant additions to other demands for the limited supplies of goods available.

In addition to these primary findings, the survey provided a number of items of information foreshadowing developments of the year. For example:

(1) Expenditures, including those for durable goods, would be at such a level in relation to income for most groups that the volume of current saving would decline.

(2) The use of instalment and mortgage credit during the year would be substantial, and would add to funds available from income for expenditures on durable goods and housing.

(3) Use of liquid assets for down payments on durable goods and houses would add significantly to available funds from income for spending.

(4) Transfers of liquid assets to other forms of investment would exert some inflationary pressure in investment and realty markets.

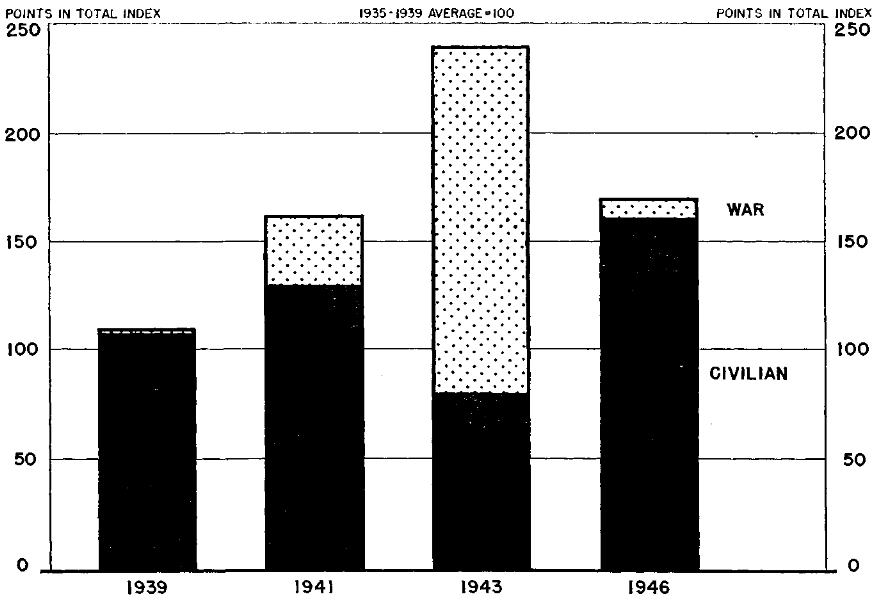
All in all, the picture presented by the survey as of the first quarter of 1946 was one of strong inflationary developments in consumer goods and investment markets over the months then ahead. The composite of plans and expectations of various consumer groups as assembled in the survey was substantially borne out by consumer income, expenditure, saving, and debt developments in 1946.

DEMAND, PRODUCTION, AND PRICES

During all of 1946 demand from both domestic and foreign sources continued strong and widespread shortages persisted despite a sharp curtailment in purchases for military purposes, a substantial increase in the working force as veterans returned to civilian life, and a large expansion in production for peacetime purposes. As a result of continued shortages of goods, and often of manpower, and of drastic and irregular alterations in the stabilization program, prices increased sharply. The greatest increases occurred in the summer during the lapse of price controls and late in the autumn when controls were largely abandoned, but in the early part of 1947 there were further general price increases. With prices up sharply over the year, with some prices apparently very high in relation to other prices and to costs, and with inventories considerably increased, there was some question at the beginning of 1947 concerning the continuance of prevailing prices and of the high levels of demand, activity, and employment that had characterized 1946. There were many elements of strength in the situation, including large backlogs of deferred requirements and purchasing power, and as the year 1946 ended production and employment were still increasing. It was yet to be determined whether inflationary influences had spent their force or whether they might lead to still further price advances, and what the nature, extent, and timing of subsequent readjustments might be.

Increased production and continued shortages. Industrial production, once again consisting almost entirely of production of goods for civilian use, was about 55 per cent larger in 1946 than in 1939; agricultural output was about 25 per cent larger; and activity was substantially above prewar levels in the transportation, trade, and service industries. In comparison with the war years, industrial production for civilian purposes was up about 100 per cent, as shown on the chart, although total industrial production was down about one-third. Drastic reduction of output for war purposes was reflected in these changes. War production—including munitions and supplies for the armed forces of the United States, industrial equipment essential for war production, and all such goods provided to Allied nations under lend-lease—in 1943 and 1944 had been roughly two-thirds of all output in industry while in the economy as a whole war activities had represented something over two-fifths of the total.

INDUSTRIAL PRODUCTION
FOR WAR AND CIVILIAN PURPOSES



Shortages of finished goods persisted in 1946, partly because some of the increased output went to build up depleted business inventories of materials, goods in process, and finished products. In certain instances, also, products were accumulated and temporarily withheld from the market in anticipation of higher prices. The volume of output, while large as compared with prewar output, fell short of postwar capacity, especially during the early part of 1946, owing to lack of balanced supplies of materials and component parts and to prolonged labor-management disputes in important industries, including those producing steel, automobiles, electrical equipment, and coal. And, even at capacity, production would not have been sufficient to meet all demands quickly, chiefly because many demands had been accumulated over a period of several years. Such deferred demands were particularly large for new housing, for some types of industrial and commercial facilities, and for durable consumers' goods, especially automobiles and major electrical appliances. But in this initial period there were also important deferred demands for semidurable goods, such as men's clothing and textile housefurnishings.

Strong demand, especially for nondurable goods and services, reflected in part a disposition on the part of buyers to spend freely to meet their requirements. This disposition was evident in markets for both consumers' and producers' goods and could be attributed in part to the unusually strong financial positions prevailing at the beginning of the year. Funds had been accumulated in large volume when goods were not available for purchase and when prices in general were being effectively controlled. As pointed out elsewhere in this report, these accumulated funds not only provided a backlog of purchasing power for immediate use but also encouraged the spending of current incomes, which were more than double those of prewar years. In the war period net current savings of individuals, representing the difference between new savings and drafts on past savings, had risen to over 30 per cent of income after personal taxes. In the latter part of 1945 they began to decline and by the end of 1946 they were down to only about 11 per cent of current income. This was only slightly above the level prevailing before the war when incomes were not so high and all sorts of goods were available for purchase. In the case of foreign buyers, needs for food and for equipment for rehabilitation were urgent in many countries and sufficient funds were available, on either a relief or a commercial basis, to finance purchase of more goods than could be obtained here under prevailing conditions.

Modification of stabilization program. With shortages continuing in many lines and with no important surpluses in evidence, the problem of preventing inflationary price increases continued to be of great significance for the economy. The necessity of stabilization as a wartime measure, however, no longer provided over-riding support for the various types of direct and indirect controls designed to curb inflationary developments in prices and costs—controls which had never extended to prices of existing properties such as urban and farm real estate. Consequently, in a series of administrative and legislative actions, beginning immediately after the end of the war with Japan in August 1945, the stabilization program was modified, and finally, in October and November of 1946, largely abandoned.

Modification of the stabilization program proceeded at an uneven pace and at times controls previously set aside were reinstituted. Thus, controls over activity in the building field, largely withdrawn in the autumn of 1945, were reinstated and extended in the early part of 1946 in an attempt to stimulate construction of housing for veterans. Also, action was taken in the spring to restrict wheat consumption in order to provide aid to people in countries where starvation threatened. And in the commodity price field, after a brief period of experimentation with free markets in July, controls were reimposed in modified form.

In general, however, there was growing opposition to restrictive measures. This opposition was based partly on doubt about the effectiveness of selected control measures. There was skepticism of their efficacy in preventing price increases, providing a reasonable balance between costs and prices, promoting production of peacetime essentials, and attracting to this country a proper share of the materials available abroad. In some lines supplies were withheld from the market in protest against continued price controls. In these circumstances, formulation and enforcement of a stabilization program appropriate to the times became increasingly difficult and in the end controls were removed while shortages still constituted a real threat of further inflationary price advances.

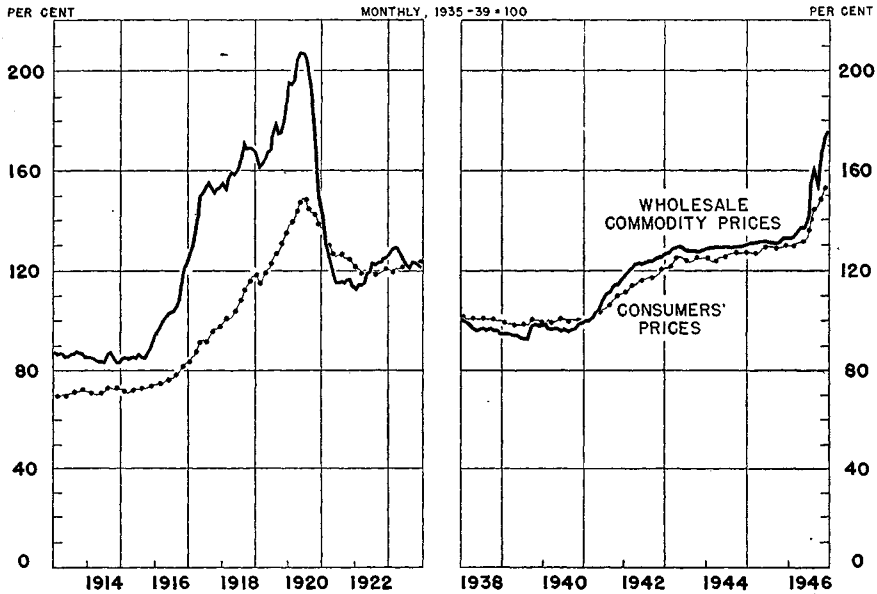
Higher prices. The continued shortages of goods and services and the weakening of the stabilization program contributed largely to widespread increases in commodity prices, wage rates, and property values during 1946. These increases were to a degree interdependent and cumulative, and they all affected the nature of the stabilization program. Increases in prices reflected the strong sellers' market as well as higher costs, and returns to business and agriculture increased sharply during the year.

The increases in wage rates came in greater part during the early months of the year when new contracts were negotiated in a number of leading industries following strikes. As increases spread to other lines, however, the general course of rates continued upward throughout the year. In manufacturing, with average hours of work per week practically unchanged, average hourly earnings rose from $1.00 in December 1945 to $1.15 in December 1946. In nonmanufacturing industries, also, wage rates rose throughout the year.

Commodity prices generally moved upward in the first half of 1946, especially in wholesale markets, although most of the year's large advance came later. The official index showed a rise of 5 per cent in wholesale prices in the first half-year and the actual rise appears to have been somewhat greater, reflecting in part the transaction of an increasing volume of business at above ceiling prices, as, for example, in the building materials field. During the lapse of price control in July, prices of agricultural products and their manufactures increased sharply. In the autumn, when most remaining controls were abolished, there were further increases in the prices of these products and sharp advances in the prices of other commodities, such as metals and metal products. At the end of the year wholesale prices of commodities were about one-third higher than at the beginning of the year and consumer prices, including rents, which showed little change, were up 18 per cent.

The rise during the year of one-third in wholesale prices as a group reflected advances of nearly 50 per cent for foods, due in part to withdrawal of subsidies; about the same percentage for hides and leather products; about 30 per cent for farm products, textile products, chemicals, metal products, and building materials; and less marked increases for other groups of products. The level reached by wholesale prices, as shown in the chart, was three-fourths above the 1935-39 average, with by far the greatest increase shown by agricultural products.

PRICES



NOTE: Bureau of Labor Statistics indexes. Index of wholesale prices converted to 1935-39 base by Federal Reserve.

Consumer prices reached a level one-half above the prewar average despite stability in rents. In general, except for agricultural products and their manufactures, the increases in prices over prewar levels were not so large as those shown for the First World War period. The changes in consumers' prices and in wholesale prices shown in the accompanying chart are overstated somewhat, since the indexes contained fewer quotations for the more slowly moving finished products in the earlier period than they have in recent years.

In markets for real property, price advances were marked in 1946, with sharp increases in urban values through the summer and with continued increases in farm values of a more gradual sort, amounting to about 14 per cent for the year as a whole. Urban residential property values in many instances reached levels more than double those prevailing before the war and on the average were probably three-fourths above the prewar level. Farm real estate values in November were 83 per cent above the 1935-39 average, with increases ranging from about 40 per cent in the Boston Reserve District to around 100 per cent in the Cleveland, Richmond, Atlanta, St. Louis, and San Francisco Districts.

Increased incomes. Higher prices, higher wage rates, and higher profit rates, together with increased production and employment for civilian purposes, raised the dollar volume of gross national product steadily throughout 1946, despite further curtailment of military activities. In the fourth quarter, at an annual rate of nearly 205 billion dollars, the gross product was close to the wartime peak of 208 billion dollars reached in the second quarter of 1945 and about 20 billion dollars above the level of the fourth quarter of 1945.

The decline in military activities during 1946 was reflected in a reduction of 10 billion dollars in the annual rate of payments to the armed forces (from 14 billion dollars in the last quarter of 1945 to 4 billion in the last quarter of 1946) as their number was reduced sharply from 10 million to 2 million. In the same period there was a sharp decline in Federal outlays for goods, chiefly for military purposes.

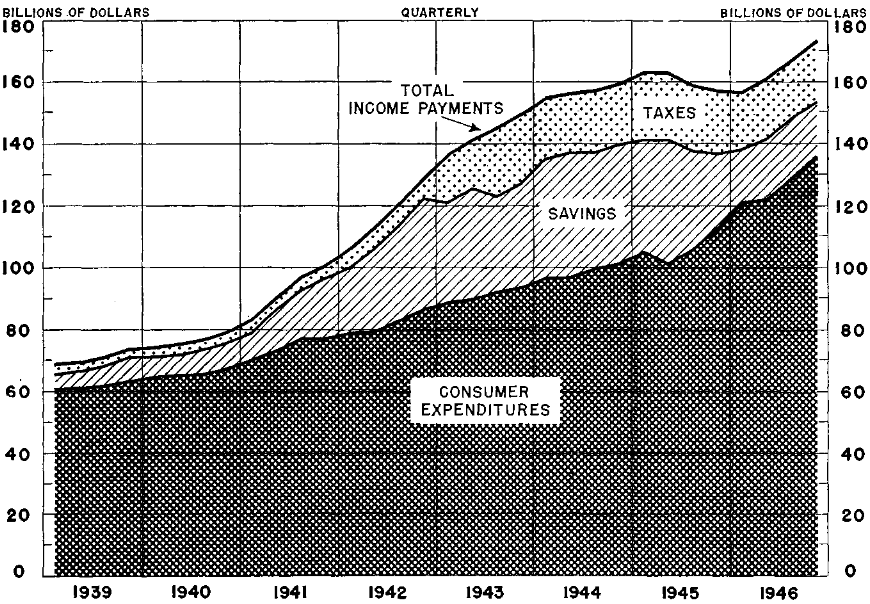
Meanwhile employment in the production of goods and services for civilian purposes increased sharply and the total number of persons employed, excluding those in the armed forces, rose from 51.4 million in the fourth quarter of 1945 to 56.8 million in the fourth quarter of 1946. This rise in employment, with average hours of work per week showing little decline and with wage rates rising, was reflected in an increase of 17 billion dollars or nearly one-fourth in the annual rate of private wage and salary payments. This increase more than offset the decline of 10 billion dollars in payments to the armed forces. The sharpest percentage increase was in the construction industry but there were substantial increases in trade, manufacturing, and mining and less marked increases in other lines.

From the last quarter of 1945 to the corresponding period in 1946, the estimated annual rate of corporate profits after taxes rose from about 7 billion dollars to fully twice that amount, and the rise for farm and other entrepreneurial income, excluding net rents and royalties, was from 26 billion dollars to 35 billion, reflecting increases both for farmers and for small businesses, chiefly in trade and service activities. The sharp rise in corporate earnings reflected not only the transaction of a larger volume of business at higher prices, but also elimination of the excess profits tax, a reduction in corporate income tax rates, and a considerable increase in inventory profits.

In agriculture price advances were of special importance and, although the volume of marketings showed little rise from the fourth quarter of 1945 to the fourth quarter of 1946, net income of farm operators increased by about one-half. For the year as a whole the rise, as estimated by the Department of Agriculture, was 14 per cent, from 13 billion dollars to 15 billion. Cash receipts from marketings showed a rise of 15 per cent, with the greatest increases in cotton (60 per cent) and in feed grains (40 per cent). Cash returns from marketings of meat animals and dairy products were up about 18 per cent. Returns from most crops other than cotton and food grains showed less increase.

INDIVIDUAL INCOMES, EXPENDITURES, AND TAXES

SEASONALLY ADJUSTED, ANNUAL BASIS



NOTE: Department of Commerce estimates. Amounts indicated as "Savings" represent excess of individual incomes over consumer expenditures and taxes.

Income payments to individuals, as shown on the chart, rose to a new peak rate of 173 billion dollars in the fourth quarter of 1946, notwithstanding continued reductions in payments to the armed forces. This rate was about 16 billion dollars or 10 per cent higher than that in the fourth quarter of 1945 and nearly two and a half times the 1939 rate of 71 billion dollars.

Rise in consumer expenditures. Consumers were in a position to buy additional supplies of goods as they became available even though prices were considerably higher. Incomes were higher, Federal personal tax rates had been lowered somewhat at the beginning of 1946, holdings of liquid assets were substantial, and credit was readily available. In particular instances consumers showed an unwillingness to pay the advanced prices, but in general they spent rather freely. Consequently the rapid rise in consumer expenditures which had begun soon after the surrender of Japan continued through 1946. Such outlays in the fourth quarter of 1946 were about 20 per cent larger than in the fourth quarter of 1945 and nearly 35 per cent larger than in the second quarter of 1945.

In the initial stages of the transition period during the latter part of 1945, the rise in consumer expenditures was mostly in outlays for food, clothing and other nondurable or semidurable goods, as shown in the table. This rise was due primarily to the increased availability of such goods for civilian consumption and to the increase in the civilian population as veterans returned. In the first half of 1946 supplies of furniture, electrical appliances, and various other durable consumers' goods increased and for this group as a whole the rise in outlays from the fourth quarter level was about as large as it was for nondurable goods, although supplies of new passenger automobiles and some other durable consumers' goods continued to be very restricted. In this period there was an increase also in expenditures for services, as manpower and supplies became more readily available.

In the second half of 1946 price advances accounted for the major share of the further rise in outlays. The physical volume of nondurable goods sold to consumers apparently did not increase after the middle of the year and in some lines declined. Supplies of durable goods generally increased and for the first time in the postwar period deliveries of new passenger cars were in substantial volume.

CONSUMER EXPENDITURES, 1945 AND 1946

[Seasonally adjusted annual rates, in billions of dollars]

Year and quarter	Total	Durable goods	Nondurable goods	Services
1945—First	105.0	7.4	65.0	32.6
Second	101.8	7.1	61.5	33.2
Third	106.0	7.4	65.1	33.5
Fourth	113.0	9.0	70.6	33.3
1946—First	121.0	11.7	75.1	34.2
Second	122.1	13.1	74.0	35.0
Third	129.6	15.0	78.3	36.3
Fourth	136.0	16.7	81.8	37.5

SOURCE: Department of Commerce.

Rise in business outlays. Throughout the year business outlays for nearly all purposes were large and growing. Producers and distributors were increasing their inventories, which quite generally had been depleted, and were improving their plant and other operating facilities either through repair and modernization or through expansion. In the early part of the year business enterprises were able to increase their inventories at an annual rate of only about 4 billion dollars. Demands for finished products continued to be insistent and supplies of materials continued short. In the second half of the year business holdings of inventories increased at an estimated annual rate of around 9 billion dollars, not counting upward revaluation of inventories as prices advanced. At this exceptionally high rate, inventory accumulation accounted for an important part of current production.

Outlays for capital improvements increased considerably during 1946, continuing the advance begun in the early part of 1945. Business expenditures for durable goods rose from an annual rate of 8 billion dollars in the fourth quarter of 1945 to a rate of nearly 16 billion in the fourth quarter of 1946. Substantial amounts of machine tools were being acquired from the surplus supplies of the Federal Government. Outlays for new plant facilities also rose during this period, although they were restricted somewhat by shortages of materials and by Federal action aimed to channel a substantial share of lumber and other scarce building materials and supplies into new housing for veterans.

The value of private residential building, which had already increased considerably in the latter part of 1945, rose sharply through the summer of 1946, reflecting increasing supplies of materials, strong demand conditions, and increasing costs. Later there was a marked decline in the number of new houses started and some reduction in the amount of work under way, but the level at the end of the year was considerably more than double that of a year earlier. Expenditures for private residential building during the year totaled 3.3 billion dollars, as compared with 0.7 billion in 1945 and 2.8 billion in 1941, when building costs were not so high by a considerable margin.

Costs of building rose rapidly in 1946 partly as a result of ceiling price adjustments made in the early part of the year, but mainly because of increasing black-market operations, growing disruptions resulting from uneven flow of materials, and, in the latter part of the year, the removal of controls over prices of materials.

During the year as a whole, with special efforts to stimulate production of materials and to allocate them to residential building for veterans, approximately 670,000 privately financed permanent nonfarm dwelling units were started. About half of these were completed during the year along with 125,000 units started in 1945. These new units, together with 45,000 units in converted structures, made a total of about a half million units added to the existing supply of 31.5 million. In addition, accommodations of a temporary sort were provided for 200,000 families and many single persons. Roughly 350,000 permanent units were carried over unfinished into 1947.

Further decline in Government outlays. Government expenditures for goods and services declined further during 1946, especially during the first three quarters, as continued sharp decreases in Federal war outlays were offset only in small part by increases in Federal nonwar outlays and in State and local government expenditures. The annual rate of expenditures for goods and services by all governmental units in the fourth quarter was about

30 billion dollars, divided evenly among Federal war outlays, Federal non-war outlays, and State and local outlays taken together. These figures do not include various other governmental expenditures such as payments to veterans and social security benefits.

The course of consumer expenditures, private outlays for capital formation, and Government expenditures for goods and services is shown in the accompanying table for the years 1945 and 1946. The figures for private capital formation, it may be noted, include figures representing the excess of exports over imports of goods and services, as well as the various business outlays discussed above. Foreign trade is discussed in another section of this report.

EXPENDITURES FOR GOODS AND SERVICES, 1945 AND 1946

[Seasonally adjusted annual rates, in billions of dollars]

Year and quarter	Total expenditures (Gross national product)	Government expenditures for goods and services	Private gross capital formation	Consumer expenditures for goods and services
1939	88.6	16.0	10.9	61.7
1940	97.1	16.7	14.8	65.7
1941	120.2	26.5	19.1	74.6
1942	152.3	62.7	7.6	82.0
1943	187.4	93.5	2.5	91.3
1944	197.6	97.1	2.0	98.5
1945	199.2	83.6	9.1	106.4
1946	194.0	34.7	32.1	127.2
1945—First	205.1	96.5	3.6	105.0
Second	208.2	99.8	6.6	101.8
Third	198.2	81.0	11.2	106.0
Fourth	185.2	57.2	15.0	113.0
1946—First	183.7	39.6	23.1	121.0
Second	190.2	36.7	31.4	122.1
Third	196.6	31.3	35.7	129.6
Fourth	204.7	30.8	37.9	136.0

SOURCE: Department of Commerce.

General situation at end of 1946. The general situation throughout the year 1946, then, was one of strong demand for goods and services, of high incomes, and of little unemployment. In many quarters, however, doubt was being expressed in the latter part of the year concerning the maintenance of these conditions, in view of various unstable elements in the situation. Price advances had been large, in some cases very large, and increases in income uneven. In consequence, the real incomes of many people in terms of command over goods and services were reduced. Moreover, many new price relationships had developed, as, for example, between agricultural and non-agricultural commodities, and they appeared unstable from a longer-range point of view. Similarly, many of the adjustments of production to meet the unusual demand situation of the immediate postwar period seemed likely to prove of a temporary nature. Production for inventory had become an important part of the total and one which clearly could not be sustained. It may be expected that backlogs of demand will eventually be exploited, business inventory requirements will be met and exceeded, and unusual limitations on supplies of commodities, both domestic and imported, will disappear.

In the latter part of the year inflationary developments in a few lines were being followed by reactions. Such reactions as occurred, however, were limited to reductions in buying, as by department stores following a leveling off in their sales, and to reductions in prices of some basic commodities such as cotton and corn and certain finished luxury goods such as fur coats and sport clothes. Prices in futures markets, particularly for grains, were below spot prices, reflecting the prospect of future increases in supply. The quality of products was generally improving and the terms of sale in many instances were being readjusted to peacetime standards, as in cases where escalator clauses in contracts were being eliminated. On the other hand, prices were still advancing for some types of commodities, particularly metals and metal products and building materials, in which there were continued shortages. Export demand was increasing further. Production and incomes generally were continuing to expand. Thus the year 1947 was beginning with economic activity and prices at levels much higher than a year earlier but much less certain to be maintained throughout the year.

INTERNATIONAL TRADE AND FINANCE

Since the end of the war a substantial part of the productive power of the United States has been devoted to meeting the urgent requirements of foreign countries, especially the devastated areas of Europe and Asia. Gross United States exports of goods and services during 1946 amounted to 7 per cent of our gross national product. By providing this flow of supplies, accompanied by substantial measures of financial assistance, the United States made a large contribution to relief and reconstruction abroad, without which world recovery would have been seriously retarded, if not made impossible.

The value of recorded exports from the United States for the year 1946, amounting to 9.7 billion dollars, was about the same as in the previous year. Though well below the wartime level, when vast shipments of munitions were made under the lend-lease program, the value of exports last year was more than three times that of the immediate prewar years, while the volume was about twice as great. Total sales of United States merchandise during the year, including surplus property located abroad and civilian supplies furnished to occupied areas (neither of which is shown in the recorded trade data), are estimated by the Department of Commerce at 12.2 billion dollars, and total services rendered by this country at 3.1 billion dollars.

Many of the devastated areasof Europe and Asia, while dependent upon the United States for a large share of their relief and reconstruction requirements, were incapable of supplying even their normal volume of exports to this country. The dollars earned by foreign countries as suppliers of merchandise to the United States, amounting to 5.2 billion dollars, and

United States payments of 1.9 billion dollars to foreign countries on service account, covered less than half of United States exports of goods and services during the year. The balance was financed mainly through grants and credits extended by the United States Government, but there were also substantial drafts upon foreign holdings of gold and dollar resources. A broad summary of the balance of payments for the year, based mainly upon figures compiled by the Department of Commerce, is shown in the accompanying table.

INTERNATIONAL TRANSACTIONS OF THE UNITED STATES, 1946

[In billions of dollars]

Item	Credits	Debits	Net credits (+) or debits (−)
Goods and services:			
Recorded exports and imports	9.7	4.9	+4.8
Other transfers of goods	2.5	0.3	+2.2
Services	3.1	1.9	+1.2
Total goods and services	15.3	7.1	+8.2
Donations ("unilateral transfers") by the United States:			
United Nations Relief and Rehabilitation Administration			−1.5
Supplies to occupied areas			−0.6
Lend-lease			−0.1
Other Government aid (net)			−0.2
Private donations (net)			−0.7
Total			−3.1
Transfers on U. S. Government credits:			
Export-Import Bank disbursements			−1.0
British credit			−0.6
Lend-lease pipeline credits			−0.5
Surplus property credits			−0.9
Total			−3.0
Use of foreign gold and dollar resources (net)[1]			−2.0
Miscellaneous (net)			−0.1

[1] Excluding reduction of foreign claims on United States Government.

Distribution by areas. These global figures conceal marked differences in the economic and financial relations of the United States with different geographic areas. It is not feasible on the basis of existing information to present a full balance of payments of the United States with particular foreign areas, but the following table shows the recorded export and import transactions of the United States by country groups. The table has been designed to group the more significant deficit balances in accordance with the methods by which they were financed. The bilateral balances shown bear a reasonably close relation to the dollar requirements of the countries concerned even though they exclude an important volume of service transactions. The bilateral approach to the financing problem necessarily ignores the existence of multilateral settlements, but these were of relatively minor importance during 1946.

UNITED STATES FOREIGN TRADE IN 1946
[In millions of dollars]

Region and country	Exports including re-exports	General imports	Export or import (–) balance
Europe	**4,098**	**796**	**3,302**
United Kingdom	856	156	700
Western Europe (France, Belgium, Luxembourg, and Netherlands)	1,213	163	1,050
Northern Europe (Denmark, Norway, and Sweden)	323	65	258
Eastern and Southern Europe (U.S.S.R., Poland, Czechoslovakia, Austria, Yugoslavia, Albania, Italy, and Greece)	1,339	215	1,124
All other	367	197	170
Asia	**1,343**	**908**	**435**
China	466	93	373
Philippine Islands	297	40	257
All other	580	675	–195
North America	**2,544**	**1,647**	**897**
Canada	1,442	882	560
Mexico	505	233	272
All other	597	532	65
South America	**1,152**	**1,095**	**57**
Australia and Oceania	**117**	**183**	**–66**
Africa	**488**	**306**	**182**
Total	**9,742**	**4,935**	**4,807**

In the case of the United Kingdom, for example, the 700 million dollar deficit in its recorded trade with the United States was closely matched by its drafts upon credits provided by this country. The sum of 600 million dollars was drawn during the year upon the 3,750 million dollar British credit from the United States Treasury approved in July, and a further 100 million dollars in goods was shipped during the year under the general British war settlement credit.

In the case of Western Europe (France, Belgium-Luxembourg, and the Netherlands), the 1,050 million dollar merchandise import balance with the United States also corresponded closely with drafts upon United States credits by the countries in that area. During 1946 the Export-Import Bank disbursed 819 million dollars to these countries (626 million dollars to France alone), while 250 million dollars of United States exports to these countries represented deliveries under lend-lease "pipeline" credits (covering lend-lease goods on order at the end of the war).

Northern Europe (Denmark, Norway, and Sweden), on the other hand, was able to finance the bulk of its net imports from the United States out of existing dollar resources and out of earnings on service account (especially from shipping). The Swedish central bank reported a loss in its gold reserves of 100 million dollars during the year, and much of this decline may be attributed to settlement of accounts with the United States. Export-Import Bank disbursements of about 7 million dollars were made to Denmark during the year.

The needs of Eastern and Southern Europe were covered mainly through UNRRA shipments for relief and rehabilitation. Nearly 0.9 billion dollars out of the 1.1 billion dollars of UNRRA exports from the United States during 1946 was sent to the countries grouped under this heading in the accompanying table, and these deliveries covered four-fifths of the merchandise trade deficit of these countries with the United States. Much of the remaining gap was closed by United States credits, in particular 150 million dollars of deliveries to the U.S.S.R. under a lend-lease "pipeline" credit and 38 million dollars of disbursements by the Export-Import Bank on loans to Poland, Czechoslovakia, Italy, and Greece.

In the case of the Far East, a considerable contribution to the financing of the Chinese deficit was made through UNRRA deliveries amounting to perhaps 150 million dollars during the year, while the Philippine situation was met in large part by United States Government expenditures in that country. Credits to this area played a minor role during the year, and both China and the Philippines found it necessary to draw extensively upon their existing dollar resources. A number of other Asiatic countries, on the other hand (notably India and British Malaya), had a substantial export surplus to the United States.

Canada and Mexico both showed large deficits in their bilateral merchandise trade with the United States during 1946, much of which had to be met by liquidation of their existing dollar resources. Both countries, however, realized net earnings on service account, mainly as a result of tourist trade. The case of Canada is of special interest because that country, despite its deficit with the United States, had an over-all merchandise export surplus of some 400 million dollars during the year. Exports to countries other than the United States, however, were financed to a large extent by Canadian loans and relief grants so that they produced little free exchange for use by Canada in meeting payments to the United States.

The approximate balance in merchandise trade between this country and South America, taken as a whole, conceals certain import and export surpluses which are of substantial importance to the South American countries concerned, but of secondary importance in the general foreign trade of the United States. It is significant that the total gold and dollar holdings of South American countries, which increased from 1.0 billion dollars at the end of 1941 to about 2.8 billion at the end of 1945, remained practically unchanged during 1946. Although these holdings are not equally distributed among the countries on the Continent, to a considerable extent they represent funds readily available for meeting future trade requirements.

Trade with the remaining areas of the world (Africa, Australia, and Oceania) produced a small net balance in favor of the United States. On the other hand, there were substantial imports of South African gold.

In addition to recorded exports, the United States transferred merchandise valued at some 2.5 billion dollars to foreign countries during the year, the major portion of which consisted of surplus property sales and provision of civilian supplies to occupied areas. Surplus property disposals amounted to about 1.6 billion dollars. Approximately 250 million dollars of these sales were made against the cancellation of dollar claims upon the United States by China, the Philippines, and India, while 100 million represented a free grant to the Philippines. Most of the remainder was made against payment on deferred terms, at a moderate interest rate and with amortization over an extended period. By the end of 1946 sales had been negotiated for nearly 85 per cent of the surplus property located abroad and declared as of that date.

The transfers of civilian supplies to occupied areas have been estimated at 550 million dollars and were financed from War Department appropriations under its authority to provide minimum supplies to prevent "starvation, disease, or unrest" in areas under occupation by United States armed forces. The transfers give rise to general claims against the recipient countries, but the status of these claims is not well defined and deliveries under this program have been tentatively classified by the Department of Commerce as "unilateral transfers." These supplies, although shipped for the most part from the United States, do not appear in recorded merchandise exports.

Foreign gold and dollar resources. Despite the large amount of foreign grants and credits made available by the United States during 1946, foreign contries as a whole found it necessary to make substantial drafts upon their holdings of gold and dollar resources.

The net gold inflow to the United States from abroad (including net releases from earmark in this country) amounted to about 775 million dollars during the year. This movement represented a marked change from the war period, during which the United States lost gold on a substantial scale. The monetary gold stock of the United States, which reached a peak of 22.8 billion dollars shortly before Pearl Harbor, had fallen by the end of 1945 to about 20.0 billion, largely as a result of sales of gold by the United States to foreign countries supplying this market. By the end of 1946, however, it had again reached more than 20.5 billion.

The net gold inflow during the year was only slightly in excess of the amount of new gold mined in foreign countries other than the U.S.S.R. Soviet production, though not reported for many years, was undoubtedly substantial, but an even larger amount of gold was probably absorbed in private hoards throughout the world. On the whole, therefore, it is likely that aggregate holdings of gold by foreign monetary authorities declined somewhat during the year. By the end of 1946, however, these authorities probably still held nearly 16 billion dollars in gold, or 43 per cent of the world's total monetary gold reserves, whereas at the end of 1941 they held only about 10.5 billion dollars or 31 per cent of a substantially smaller total. The United States share, therefore, declined from 69 to 57 per cent during this period.

In view of the fact that such important holders of gold as the U.S.S.R., the United Kingdom, and Canada do not publish their current gold reserve positions, it is difficult to trace shifts in gold holdings among particular countries. On the basis of published figures, however, it would appear that France was the principal loser of gold during 1946. Whereas total French gold holdings exceeded 1,500 million dollars at the end of 1945, by the end of 1946 reported holdings of the Bank of France (excluding such gold as may have been held by the French Stabilization Fund on that date) amounted to only 800 million dollars. Sweden and Mexico each reported losses of about 100 million dollars in gold during the year, while scattered gains were reported by a number of other countries. It would appear that larger gains must have been realized by some of the major nonreporting countries.

Dollar balances held in the United States by foreign countries supplied a net amount of some 875 million dollars toward meeting foreign requirements during 1946. The dollar balances of foreign central banks and governments were drawn upon to the extent of over 1,100 million dollars net, mainly as a result of heavy drafts upon the British, Canadian, Philippine, and French accounts. This decline in official funds was compensated in part, however, by a widely distributed expansion of balances held for private foreign account. Both categories of foreign funds remain far above prewar levels. At the end of 1946, official balances still amounted to 3.0 billion dollars as compared with only 0.5 billion at the end of 1938 and private balances came to 3.0 billion dollars as compared with 1.7 billion in 1938.

Foreign countries also made net sales to the United States of marketable domestic securities (both stocks and bonds, including United States Government bonds) amounting to 335 million dollars during 1946. This reflected mainly liquidation of Chinese, British, and Netherlands holdings; several Latin American countries, on the other hand, were small net purchasers of securities in this country.

Prospects for 1947. With increasing supplies of goods available in the United States and with substantially higher prices on exported commodities, especially foodstuffs, the value of merchandise exports from this country during the early months of 1947 has reached record figures, far surpassing the 1946 level. The world food shortage continues to be critical, and there are immense requirements for other American products in connection with recovery and reconstruction abroad. Even in countries which escaped serious war damage and disruption, there exists a very large demand for imports arising from high levels of current domestic income and accumulated liquid funds, combined with large deferred demands for both consumers' and producers' goods which could not be satisfied under wartime conditions. United States exports may soon come to be limited mainly by the volume of available purchasing power in foreign hands. Some of this purchasing power must also be used to meet net payments to the United States on service transactions, which may again be as large as in 1946 in view of the very high level of earnings by United States shipping; small additional amounts may still be required for purchases of United States surplus property located abroad.

Foreign purchasing power for United States exports is derived from United States imports, from United States grants and credits to foreign countries, and from liquidation of foreign gold and dollar assets. It appears that the latter source may be relied upon much more heavily in 1947 than in the previous year. United States merchandise imports were far smaller in 1946 than might have been anticipated in view of the high level of domestic production and income. As supplies become more readily available in foreign areas, shipments to this country should expand considerably; merchandise imports of over 6 billion dollars may be expected for 1947.

Unilateral transfers, including the civilian supply program for occupied countries, public relief grants, and private relief and remittances will probably provide some 2.5 billion dollars. The civilian supply program is likely to be no smaller in 1947 than during the past year. UNRRA deliveries to Europe will continue through the first quarter of 1947 and shipments to the Far East some three months longer. In addition, the Congress has authorized 350 million dollars to provide supplementary relief for the period following cessation of UNRRA operations, as well as 400 million dollars for special assistance to Greece and Turkey; however, these sums will not all be delivered in 1947.

Dollar credits from various sources may provide as much as 4 billion dollars. The United Kingdom may need to draw up to 2 billion dollars upon its line of credit during 1947, both to finance its own purchases in the United States and to provide freely convertible currency for other net suppliers of the British market after the middle of the year. Export-Import Bank disbursements in 1947 have been estimated by that agency at a minimum of one billion dollars. Various other United States lending agencies, plus some private long-term American investment in foreign countries, may supply half a billion dollars, and a further half billion is likely to be forthcoming during 1947 from the International Fund and Bank, which had not yet commenced active financial operations by the end of 1946.

If grants and credits become available in this volume during 1947, foreign countries may be able, after meeting other current demands upon their supply of dollars, to finance purchases of at least 11.5 billion dollars of United States merchandise exports without drawing upon their gold and dollar assets. However, in view of urgent foreign requirements, it appears likely that foreign countries will in fact be prepared to make large further inroads upon their holdings of such assets if they can find the goods available in the United States to meet their needs. Over one billion dollars of these assets were actually liquidated in the first quarter of the year. Total exports, recorded and unrecorded, may therefore be substantially greater than the figure named above, and foreign gold and dollar reserves may suffer substantial depletion during the coming year. Such depletion of reserves, together with the rapid consumption of available grants and credits, promises to create a serious dollar financing problem for foreign countries by the end of the year.

CHANGES IN REGULATIONS OF THE BOARD OF GOVERNORS

Consumer credit. Regulation W, relating to consumer credit, was amended on three occasions during 1946. The first amendment, effective July 5, 1946, made the regulation applicable to sales of listed articles in a principal amount of $1,500 or less (there had previously been no dollar limit with respect to sales); it eliminated attic ventilating fans and automobile tires, batteries and accessories from the list of articles, and made certain technical changes. The second amendment, effective September 3, 1946, changed the regulation in two respects: The regulation was made applicable to all consumer credits up to $2,000 instead of only those up to $1,500; and the maximum maturity for instalment loans not connected with the purchase of listed articles was reduced from 18 months to 15 months.

The regulation was extensively revised effective December 1, 1946. The principal changes made by the revision were to confine it to instalment credit (by eliminating the provisions relating to charge accounts and single-payment loans) and to center it on purchases of major durable goods (by eliminating many of the articles, including all articles priced at less than $50, which had previously been listed in the regulation). In addition, the revision simplified the regulation in many respects, making it administratively more workable. The changes made by this revision and the reasons therefor are discussed more fully elsewhere in this Report.

Margin requirements for purchasing securities. As stated in the previous *Annual Report,* the Board's Regulation T, entitled "Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges" and Regulation U, entitled "Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange" were amended effective January 21, 1946 to increase margin requirements to 100 per cent both for purchases of registered securities and for short sales. Effective February 1, 1947, these requirements were reduced to 75 per cent, which was the level prevailing from July 5, 1945 to January 21, 1946.

Effective December 1, 1946, both regulations were amended so as to permit stockholders of any corporation who receive rights to subscribe to new issues to obtain credit for the purpose of exercising these rights. Securities pledged for this purpose were given a loan value of 50 per cent by the amendment. The new provision applies also to cases in which a public utility holding company, when simplifying its structure as required by the Public Utility Holding Company Act of 1935, issues to its stockholders rights to subscribe to its holdings of outstanding securities of operating companies.

Acceptances by member banks. Regulation C, relating to the acceptance by member banks of drafts or bills of exchange drawn against domestic or foreign shipments of goods or secured by warehouse receipts covering readily marketable staples and the acceptance of drafts or bills drawn for the purpose of creating dollar exchange, was revised effective August 31, 1946. The revision made no major changes of substance in the regulation, but made certain changes designed to simplify and clarify its provisions in the light of experience over a number of years.

Administrative procedure rules. Pursuant to the Administrative Procedure Act and other relevant provisions of law, the Board, effective September 11, 1946, adopted Rules of Organization and Rules of Procedure. As specified in the Administrative Procedure Act, the Rules of Organization describe the Board's central and field organization, including delegations of final authority and the places and methods by which the public may secure information or make submittals or requests, and the Rules of Procedure describe the method by which the Board's functions are carried out, its procedures and its forms.

Rules on Organization and Information and Rules on Procedure were likewise adopted effective the same date by the Federal Open Market Committee.

LITIGATION

Injunction under Regulation W. A decree restraining Motor City Credit Jewelry Co., Inc., Van Dyke, Michigan, it officers and employees from violating the Board's Regulation W was entered on February 14, 1946, in the United States District Court in Detroit. The Company was charged with numerous and repeated violations of the regulation, including failure to obtain the down payment required and falsification of its records for the purpose of concealing the failure to obtain the down payments. The effect of the decree, to which the defendants consented, is to render them liable to punishment for contempt in the event they are found in the future to have violated the regulation in any of the respects described in the decree. The text of the decree appears in the Appendix at page 105.

In addition, the Board after a full hearing suspended the license of the Company for 60 days, which had the effect of prohibiting the Company from making credit sales during the period of suspension. The Board's Order, and the Findings and Opinion upon which it was based, appear in the Appendix at pages 106-08.

Conviction for violating injunction. The United States District Court in Detroit on June 14, 1946, found that Consumers Home Equipment Company and its President had violated an injunction previously issued by that Court restricting them from violating the Board's Regulation W (see Board's *Annual Report* for 1945), and adjudged them guilty of contempt, for which it fined the Company $2,500 and sentenced its president to one year in prison. The case has been appealed to the Circuit Court of Appeals. The text of the oral Opinion of the District Court appears in the Appendix at pages 109-10.

Suit regarding condition of membership. On June 3, 1946, the suit of the Peoples Bank, Lakewood Village, California, against the individual members of the Board (which was instituted following the dismissal of a somewhat similar suit in California, as described in the Board's previous *Annual*

Report) was decided in favor of the defendants by the United States District Court for the District of Columbia. The complaint alleged that a condition of membership which had been prescribed when the bank became a member of the Federal Reserve System was unauthorized by law and asked for a declaratory judgment and for an injunction restraining the defendants from enforcing the condition. The court granted the defendants' motion for a summary judgment. The plaintiff has appealed to the Circuit Court of Appeals. The opinion of the District Court appears in the Appendix at pages 111-13.

Suit regarding removal of bank directors. On January 6, 1947, the Supreme Court of the United States sustained an order of the Board of Governors removing from office two directors of a national bank in Paterson, New Jersey. The case had reached the Supreme Court on certiorari to the United States Court of Appeals for the District of Columbia, which had reversed the decision of the District Court sustaining the Board's order (as described in the Board's previous *Annual Report*).

The Board's removal order, issued under Section 30 of the Banking Act of 1933, was predicted upon a finding that the directors had violated Section 32 of the Banking Act of 1933, which prohibits any officer, director or employee of a firm primarily engaged in the business of underwriting or distributing securities from serving at the same time as an officer, director or employee of a member bank of the Federal Reserve System. The suit was based upon the contention that the Board had transcended its authority by applying Section 32 to a situation where underwriting was not actually first in volume as compared with other businesses of the firm but was merely one of its primary activities.

The Court was unanimous in holding that the Board had not transcended its authority. On the question of jurisdiction, a majority of the Court was of the opinion that the determination of the extent of the authority granted to the Board to issue removal orders under Section 30 is subject to judicial review; but in a concurring opinion, two Justices were of the view that the question presented on the merits should be reviewable only for abuse of discretion. The opinions in the Supreme Court appear in the Appendix at pages 114-18.

LEGISLATION

Purchase of Government obligations by Federal Reserve Banks. The Second War Powers Act, enacted March 27, 1942, amended Section 14(b) of the Federal Reserve Act so as to authorize the purchase or sale by Federal Reserve Banks, directly from or to the United States, of bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed as to principal and interest, but limited the aggregate amount acquired directly from the United States and held at any one time by the twelve Federal Reserve Banks to not exceed 5 billion dollars. Another provision of the Second War Powers Act provided that such authority should terminate on December 31, 1944, or at such earlier time as Congress, by concurrent resolution, or the President, might designate. This time limit, which had been extended from time to time, was further extended until March 31, 1947, by an Act approved June 29, 1946.

Limitation on claims connected with Government checks. An Act approved March 6, 1946, gives relief to banks, merchants, and others who handle Government checks which turn out to have had forged or unauthorized endorsements. The relief given is a six-year statute of limitations on claims by the United States in such cases.

Farm tenant loans. Section 24 of the Federal Reserve Act contains limitations and restrictions upon real estate loans by national banks. By an Act approved August 14, 1946, the section was amended so as to make these limitations and restrictions inapplicable to loans for the purpose of enabling farm tenants to acquire farms when such loans are insured under the Bankhead-Jones Farm Tenant Act.

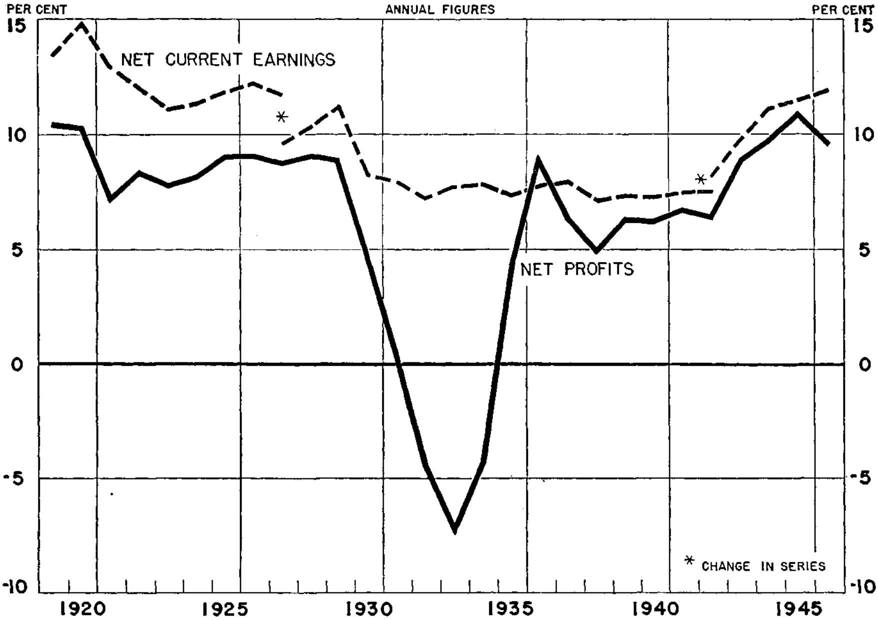
Cessation of hostilities. Although not technically legislation, reference should also be made here to the Proclamation of the President of the United States issued on December 31, 1946, terminating the period of hostilities of World War II, effective as of noon on that date. The Proclamation does not have the effect of terminating the war or of terminating the emergencies declared by the President on September 8, 1939 and May 27, 1941. Accordingly, the only statutory provisions directly concerning the Federal Reserve System which are affected by the Proclamation are those of Section 12B (h)(1) and the last paragraph of Section 19 of the Federal Reserve Act, as amended by the Act of April 13, 1943, exempting war loan accounts of the United States from deposit insurance assessments and from reserve requirements of member banks, both of which will expire six months from the date of the Proclamation.

BANKING OPERATIONS AND STRUCTURE

Bank earnings and earning assets. Member bank net profits after taxes were 758 million dollars in 1946, compared with the peak of 788 million earned in 1945. All major items of current earnings were larger, but expenses and charge-offs also were larger and profits on securities sold were considerably smaller than in the previous year. About one-third of net profits was paid out as dividends and the remainder was added to capital accounts.

Net profits of member banks in 1946 were 9.6 per cent of total capital accounts as compared with nearly 11 per cent in 1945. The decline was due in part to an increase in capital accounts. As shown in the accompanying chart, profits in 1945 as a percentage of capital accounts were at a higher level than had been previously reached. Net current earnings before income taxes continued the upward trend of recent years and were nearly 12 per cent of total capital accounts in 1946; this compared with a level of about 8 per cent during the 1930's. The ratio of net profits to capital at country banks was higher in 1946 than in 1945, while ratios for the central reserve and reserve city banks declined.

MEMBER BANK EARNINGS AND PROFITS
AS PERCENTAGES OF CAPITAL ACCOUNTS



NOTE: Net current earnings are total earnings from current operations less current operating expenses. Net profits are net current earnings plus recoveries, profits on securities, etc., less losses and charge-offs and taxes on net income. Capital accounts consist of all forms of capital, including capital notes and debentures, surplus, undivided profits, reserves for contingencies, and other miscellaneous capital accounts. Prior to 1927 profits on securities were included in current earnings; beginning in 1942 taxes on net income were excluded, while recurring depreciation was included, as a current operating expense deduction from earnings.

Earning assets of member banks amounted to 96 billion dollars at the close of 1946, a decrease of 11 billion during the year. A decline of over 15 billion dollars in holdings of United States Government obligations during the year was partly offset by an increase of over 4 billion in loans and other securities.

Two factors moderated the effect on bank earnings of the decline in holdings of Government securities. First, the decrease was entirely in short-term, low-yield Government securities, and as a result the average yield on holdings of United States Government securities increased from 1.39 per cent in 1945 to 1.48 per cent in 1946. Second, the increase in holdings of commercial and industrial, real estate, and consumer loans, with their higher yields, was an important factor in sustaining bank earnings in the face of sizable declines in low-yielding, short-term Government securities and loans for purchasing or carrying securities. Total loans of member banks, as well as commercial and industrial, real estate, and consumer loans, increased during the year and at the end of 1946 were larger than at any previous time. Changes in earning assets during the year are shown in the accompanying table.

MEMBER BANK LOANS AND INVESTMENTS
[In billions of dollars]

	Outstanding Dec. 31, 1946	Change during year	
		1946	1945
Loans and investments: total	**96.4**	**−10.8**	**+15.6**
Loans: total	**26.7**	**+3.9**	**+4.1**
Commercial and industrial loans	13.2	+4.2	+1.4
Agricultural loans	0.9	....	−0.3
Loans for purchasing or carrying securities	3.0	−3.5	+2.2
Real estate loans	5.4	+1.9	+0.2
Consumer loans	3.3	+1.4	+0.4
All other, including loans to banks	1.0	−0.1	+0.2
U. S. Goverment securities direct and guaranteed: total	**63.0**	**−15.3**	**+10.7**
Bills, certificates and notes	16.8	−16.7	+1.7
Bonds	46.2	+1.4	+9.0
State and local government securities	**3.5**	**+0.3**	**+0.4**
Other securities	**3.1**	**+0.3**	**+0.5**

Shifts in the volume and composition of bank earning assets during 1946 had their effect on earnings of the various classes of member banks. The Treasury's debt-retirement program affected the earning assets of large banks more than small ones. At central reserve city banks, the decline in holdings of Treasury certificates of indebtedness and notes and in loans on Government securities, only partly offset by increases in other loans and securities, reduced earning assets by more than 6.5 billion dollars, or 20 per cent. As a result, net current earnings of these banks were somewhat lower than in 1945. Net profits were 23 per cent lower.

At reserve city banks there was a decrease in earning assets of 4.8 billion dollars, or 12 per cent. Total loans held by these banks increased 2.3 billion dollars, although loans on securities declined about 1.0 billion. Net current earnings of these banks were higher than in 1945 and net profits were but little lower.

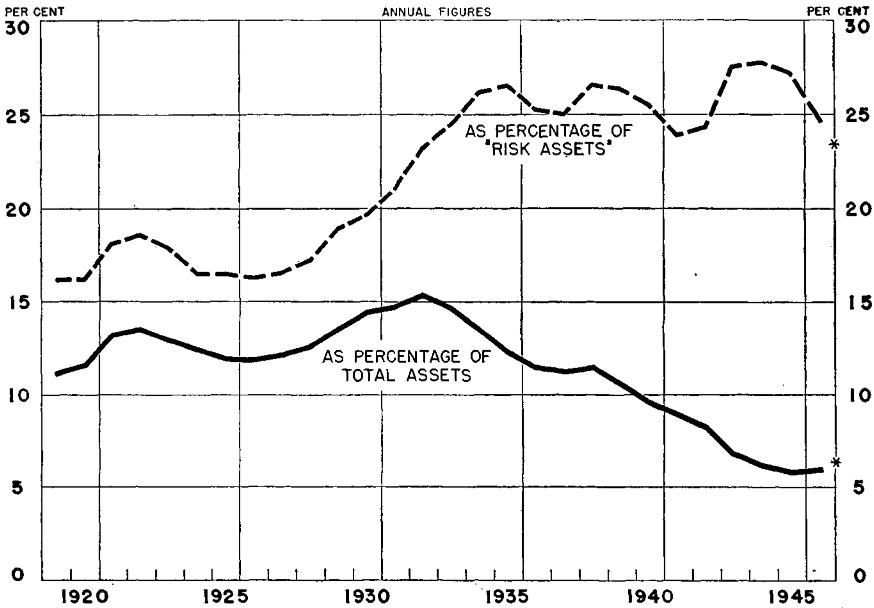
At country banks, instead of a decline in earning assets, there was an increase of 400 million dollars. A decrease of 2.4 billion dollars in holdings of Government securities was more than offset by increases in loans and other securities. The bulk of the increase in loans was in such high-yielding categories as real estate and consumer loans. Net current earnings of country banks were nearly one-third higher than in 1945 and net profits about 12 per cent higher.

Capital accounts. Capital accounts of member banks increased 510 million dollars in 1946, compared with 620 and 490 million in 1945 and 1944 respectively; most of the increase resulted from the retention of profits.

There were some sales of additional capital stock, and also some retirement of preferred stocks and capital notes held by the Reconstruction Finance Corporation. Dividend payments aggregated 267 million dollars, 21 million higher than in 1945.

As a result of the further increase in capital accounts and the decline in Government securities and deposits during the year, the ratio of member bank average capital accounts to average total assets increased slightly during the year. As shown in the accompanying chart, this was the first annual increase since 1938. While total assets of member banks have nearly tripled during the past 10 years, capital accounts have less than doubled.

MEMBER BANK CAPITAL ACCOUNTS
AS PERCENTAGE OF TOTAL ASSETS AND "RISK ASSETS"



NOTE: "Risk assets" represent total assets other than cash assets and U. S. Government securities. Capital and asset figures are based on averages of June and December call date figures 1919-40 and of three or four call date figures thereafter.
* Indicates Dec. 31, 1946, call date ratio.

The increased volume of assets during the period from 1939 to 1945 was largely represented by increased holdings of Government securities and cash assets. As a result, the percentage ratio of member bank capital accounts to total assets other than cash assets and Government securities, also shown on the chart, changed very little. In 1946, with the decline in holdings of Government securities and the increase in loans, this ratio declined somewhat. In contrast to the ratio of capital to total assets, the ratio of capital to what may be called the "risk assets" is at a much higher level than it was in the 1920's. Smaller banks generally have higher capital ratios, measured on either basis, than larger banks.

The increase in capital accounts in the aggregate kept pace with the growth of assets other than cash assets and Government securities, but the volume of bank premises, furniture and fixtures, and other real estate included in these assets has steadily declined. This has resulted from the sale of other real estate, regular depreciation charges, and substantial additional charge-offs of these assets. Real estate assets now amount to only 11 per cent of member bank capital accounts as compared with 23 per cent in 1940.

In view of the decline in holdings of Government securities and increase in loans since the end of the war, the capital accounts of some individual banks are now disproportionately low relative to their risk assets. It is important, therefore, that bank managements keep continuously under observation the composition of the assets of their institutions and, as the degree of risk in such assets increases, take such steps to strengthen the capital account by the retention of a larger share of earnings or the sale of additional stock or both as their individual situations may require.

Changes in number of banking offices. For the third successive year the number of banking offices in the United States, exclusive of offices at military reservations, has shown an increase, and the net growth in 1946 was twice that of the previous year. The net increases during the last three years were: 225 in 1946, 111 in 1945, and 12 in 1944. The gross increase in number of de novo banks and branches was considerably higher: 301 in 1946, 185 in 1945, and 108 in 1944. The gross increase in number of new banks (head offices) opened in the last three years was nearly as large as the number of new banks organized in the eight-year period 1936-43, while the number of new branches opened in 1946 was nearly as large as the total for the four preceding years. At the end of 1946 there were 18,644 banking offices, comprising 14,585 banks and 4,059 branches, besides 79 "banking facilities" at military reservations.

The number of banks (head offices) increased by 32 in 1946 following an increase of 18 in 1945. These were the first increases since 1934, when many banks were reopened after the banking holiday. During 1946, 144 new banks opened for business, of which 30 were member banks, 98 insured nonmember banks, and 16 noninsured banks. Two nonmember banks that had previously been placed in voluntary liquidation resumed business. However, through consolidations and liquidations, 112 head offices were discontinued, 54 of which became branches. These changes resulted in a total of 14,585 banks in operation at the end of 1946—14,044 commercial banks and 541 mutual savings banks.

During 1946 there was a net increase of 193 in the number of branches and additional offices, exclusive of facilities at military reservations. This was more than double the increase of 94 in 1945, and resulted in a year-end total of 4,059. The number of such offices has increased in every year since 1933, except in 1942 when it remained unchanged. There were about 350 banking facilities (not included in the foregoing figures) in operation at military reservations at the end of the war. This number had declined to 241 by the end of 1945 and to 79 by the end of 1946.

Increase in Federal Reserve membership. Membership in the Federal Reserve System continued to increase in 1946, registering a net gain of 16 banks for the year compared with a net gain of 70 banks during 1945. The number of national banks decreased by 10 while the number of State member banks increased by 26. Of the 65 State banks admitted to membership, 9 were newly organized and 56 were already in operation. All but 5 of the 56 had previously been admitted to membership in the Federal Deposit Insurance Corporation. Total deposits of these 56 banks were about 300 million dollars. About one-half of the State banks admitted to membership were located in three Federal Reserve Districts—Cleveland, Chicago, and Dallas.

The 6,900 member banks in operation at the end of 1946 accounted for 49 per cent of the number and 85 per cent of the volume of the deposits of all commercial banks in the country; these percentages were 49 and 86 respectively at the end of 1945. The State member banks accounted for 21 per cent of the number and 65 per cent of the volume of the deposits of all State commercial banks; corresponding percentages were 21 and 69 respectively the previous year.

Par and nonpar banks. At the end of 1946 there were 11,957 banks on the Federal Reserve Par List, a net increase of 88 during the year, and 2,086 banks not on the Par List, a net decrease of 47.[2] These changes represent a continuation of the trend of several years. The banks on the Par List constituted about 85 per cent of all banks on which checks are drawn and held about 98 per cent of the deposits of all commercial banks in the country. In addition, 3,576 or 92 per cent of the 3,902 branches of commercial banks in existence at the end of 1946 were remitting at par.

During 1946, 198 banks were added to the Par List, 8 withdrew from the Par List, and 103 par banks terminated existence. Of the 103 par banks that terminated existence, 85 were absorbed by other par banks, and 50 of the banks thus absorbed were converted into branches. Net increases of more than 10 par banks occurred during the year in the following five States: Illinois 19, Texas 15, South Carolina 13, and Florida and Virginia 11 each.

At the end of 1946 all banks in 25 States and the District of Columbia were on the Federal Reserve Par List. In each of 8 other States the number of nonpar banks was small: Montana 1, Illinois and Kansas 2 each, West Virginia 3, Washington 5, Nebraska 8, Oklahoma 10, and Virginia 11. The remaining 15 States had approximately 98 per cent of the banks not on the Par List and were: Minnesota 416, Georgia 283, Mississippi 165, Arkansas 130, North Carolina 119, Alabama 113, Wisconsin 112, North Dakota 106, Tennessee 103, Louisiana and South Dakota 102 each, South Carolina 95, Missouri 72, Florida 64, and Texas 62.

[2] The Federal Reserve Par List comprises all member banks, which are required under the law to remit at par for checks forwarded to them by the Reserve Banks for payment, and such nonmember banks as have agreed to remit at par.

Check routing symbols. Considerable progress was made during 1946 in the use of routing symbols on checks to facilitate their collection, pursuant to the program inaugurated by the American Bankers Association and the Federal Reserve System in June 1945. Of the 11,957 banks on the Federal Reserve Par List as of December 31, 1946, almost 85 per cent have had check routing symbols printed in the approved location on some of their checks, i.e. in the upper righthand corner of the checks. The routing symbol is written as if it were the denominator of a fraction, the numerator of which is the ABA transit number. About 50 per cent of the out-of-town branches of par banks to which individual ABA transit numbers have been assigned were using some checks with the routing symbol printed in the approved location.

On the basis of a survey made in December 1946, it was found that 25 per cent of all checks clearing through Federal Reserve Banks carried routing symbols in the approved location. The high percentage of par banks and their out-of-town branches using the routing symbol is not yet reflected in the volume of checks handled because of the large stocks of checks that were on hand at the inception of the program (destruction of these inventories was not advised), and because of personnel and material shortages in the check printing industry. With the gradual exhaustion of previously existing stocks of checks and the solution of printing difficulties, it is anticipated that the coming year will see a considerable increase in the volume of checks with routing symbols.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

The volume of banking activity continued at a high level in 1946. The year was marked by increase in demand for commercial and consumer credit and the development of the expected shifting in character of bank assets incident to conversion to peacetime activity. By the end of the year total loans of all banks in the United States were larger than in any year since 1930, and member bank loans were at the highest level on record. Commercial and industrial loans of member banks increased during the year by 4.2 billion dollars or 47 per cent.

The great and increasing volume of loans brings a new phase of banking to many who have entered the banking and supervisory fields since 1932 and whose banking and credit experience has been largely during periods of recovery and the abnormal conditions of wartime. Bank management and the supervisory authorities have also been faced with problems incident to the development of new types of financing and the entry of commercial banks into new credit fields.

Examination of Federal Reserve Banks. The Board's Division of Examinations examined the twelve Federal Reserve Banks and their twenty-four branches during the year as required by law.

Examination of State member banks. State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to have at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. The program for the examination of State member banks in 1946 was substantially completed. In order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking authorities or alternate examinations are made by agreement with State authorities.

The practice of holding periodic conferences with representatives of the bank examination departments of the twelve Federal Reserve Banks, which was curtailed during the war years, was resumed in 1946. A conference was held in the Board's offices in Washington on September 11 through September 13, in which representatives of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Reconstruction Finance Corporation participated. Particular consideration was given to the broad problems incident to reconversion as well as to technical developments. The Secretary of the Treasury and representatives of the Federal Housing Administration and the Farm Credit Administration addressed the Conference.

Bank holding companies. During 1946 the Board acted upon applications for voting permits submitted by holding company affiliates of banks and authorized the issuance of three permits for general purposes and four permits for limited purposes.

The regular annual reports were obtained from holding company affiliates to provide information with respect to the organizations to which voting permits have been granted. As in previous years, a substantial number of the holding company affiliates were examined during the year by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

The existing statutes do not provide adequate means for regulation of bank holding companies. Recommendations have heretofore been made by the Board with a view toward the strengthening of such regulation, and such recommendations are included elsewhere in this report.

Trust powers of national banks. During the year 1946, 18 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11(k) of the Federal Reserve Act. This number includes the grant of additional powers to 3 banks which previously had been granted certain trust powers. Trust powers of 20 national banks were terminated, 12 by voluntary liquidation or consolidation and 8 by voluntary surrender. At the end of 1946, there were 1,783 national banks holding permits to exercise trust powers. A list of such banks, with indication of the power or powers each bank is authorized to exercise, will be supplied to those requesting it.

Acceptance powers of member banks. During the year the Board approved three applications made by member banks, pursuant to the provisions of Section 13 of the Federal Reserve Act, for increased acceptance powers. One member bank was granted permission to accept drafts or bills of exchange to an amount not exceeding at any one time, in the aggregate, 100 per cent of its paid-up and unimpaired capital stock and surplus, and the applications of two member banks for permission to accept drafts or bills drawn to furnish dollar exchange were also approved.

The Reserve Banks, during the year, reviewed the list of member banks in their districts holding increased acceptance powers to ascertain whether such powers were needed. The powers had been granted many years ago in most cases and, in view of changed conditions, up to the end of the year 33 member banks had voluntarily surrendered the power to accept up to 100 per cent of their capital stock and surplus and one member bank had voluntarily relinquished its power to accept drafts or bills drawn to furnish dollar exchange.

Foreign branches and banking corporations. During 1946 the Board approved two applications made by a member bank pursuant to the provisions of Section 25 of the Federal Reserve Act for permission to establish foreign branches. No new foreign branches of member banks were opened during the year but the Tokyo Branch of the National City Bank of New York, which had been closed at the outbreak of the war, resumed limited operations, and no branches were closed. The establishment of four foreign branches, authorized by the Board in previous years, was not consummated and the authorities granted with respect thereto lapsed during the year. Still in effect at the end of the year were authorizations granted in previous years for the establishment of three foreign branches which, however, had not been established as of that date.

At the end of 1946, seven member banks were operating a total of 73 branches in 21 foreign countries and possessions of the United States. Of the 73 branches, four national banks were operating 67, and three State member banks were operating 6. The foreign branches were distributed geographically as follows:

Latin America		42
Argentina	10	
Brazil	4	
Chile	2	
Colombia	3	
Cuba	16	
Mexico	1	
Panama	3	
Peru	1	
Uruguay	1	
Venezuela	1	
Continental Europe		2
Belgium	1	
France	1	
England		10
Far East		8
China	2	
Hong Kong	1	
India	2	
Japan	1	
Philippines	1	
Singapore	1	
U. S. Possessions		11
Canal Zone	4	
Puerto Rico	7	
Total		73

There was no change during the year in the list of the five corporations organized under State laws which operate under agreements entered into with the Board pursuant to Section 25 of the Federal Reserve Act relating to the investment by member banks in the stock of corporations engaged principally in international or foreign banking. These corporations are: First of Boston International Corporation, French American Banking Corporation, International Banking Corporation, Morgan & Cie., Incorporated, and Bankers Company of New York. Two of the five have no foreign branches, one operates a branch in England, one operates a branch in France, and one has an English fiduciary affiliate.

There is in operation one banking corporation, The Chase Bank, organized under the provisions of Section 25(a) of the Federal Reserve Act to engage in international or foreign banking. The bank operates a branch in France, two branches in China, a branch in Hong Kong, and has a fiduciary affiliate in England. Its head office was examined during the year by the Board's Division of Examinations.

RESERVE BANK OPERATIONS

Volume of operations. During 1946 the operations of the Federal Reserve Banks as a whole declined, primarily because of the sharp decrease in volume of Government security issues and redemptions. Certain other fiscal agency operations also decreased, such as those pertaining to guaranteed loans under Regulation V, ration checks, and various loan, purchasing, and subsidy programs carried on by the Commodity Credit Corporation and the Reconstruction Finance Corporation. The volume of Government checks handled decreased substantially. On the other hand, the volume of other checks and of paper currency and coin handled continued to increase and reached new peaks.

The V loan program carried on by the Federal Reserve Banks under the general supervision of the Board of Governors for the War Department, the Navy Department, and the United States Maritime Commission has been rapidly drawing to a close, and liquidation of the loans made under the plan has been vigorously pursued. The amount of guaranteed loans outstanding declined from 510 million dollars at the first of the year to 19 million at the end of the year. In the same period the amount of credit available to borrowers, in addition to loans outstanding, decreased from 967 million to 29 million dollars. Only 14 guarantee agreements, for loans of about 5 million dollars in the aggregate, were authorized during 1946. The last authorization was in May 1946.

Reserve Bank holdings of discounts and advances in 1946 were below the level of 1945 for the System as a whole, some Reserve Banks having increases and some decreases. A considerable volume of bankers' acceptances was offered to the Reserve Banks for purchase at the established buying rate. These offerings were made within a short period—from March through July. Government securities held in the System Open Market Account, and

Treasury bills acquired from member banks and others under agreements to resell upon demand prior to maturity at the established buying rate, were larger in 1946 than in 1945. The amount of industrial loans made to provide working capital for industry under Section 13b of the Federal Reserve Act declined, but commitments to make industrial loans increased and at the end of the year were larger than in any other year since 1943.

Table 5 on page 77 shows the volume of operations in the principal departments of the Federal Reserve Banks for the past five years. Average holdings of loans and securities, and earnings thereon, are given in the table below:

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1943-46

[Dollar amounts in thousands]

Item and year	Total	Discounts and advances	Acceptances purchased	U. S. Government securities, direct and guaranteed	Industrial loans
Daily average holdings:					
1943	$ 7,761,651	$ 24,759	....	$ 7,724,488	$12,404
1944	14,917,596	135,459	....	14,772,201	9,936
1945	21,742,589	375,958	$ 22	21,363,244	3,365
1946	23,570,260	310,308	8,457	23,250,195	1,300
Earnings:					
1943	68,656	152	....	68,090	414
1944	103,837	724	....	102,810	303
1945	141,631	1,977	(1)	139,553	101
1946	149,703	2,497	43	147,125	38
Average rate of earnings (per cent):					
1943	0.88	0.61	....	0.88	3.34
1944	0.70	0.53	....	0.70	3.05
1945	0.65	0.53	0.50	0.65	2.99
1946	0.64	0.80	0.51	0.63	2.90

[1] Less than $500.

Earnings and expenses. Current earnings, current expenses, and the distribution of net earnings of the various Federal Reserve Banks are given in detail in Table 6 on page 78, and a condensed annual statement since 1913 for all the Reserve Banks combined is given on page 80. The table below shows a condensed summary for all of the Reserve Banks for the years 1945 and 1946. Current earnings were 150 million dollars in 1946 as compared

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS, 1945 AND 1946

[In thousands of dollars]

Item	1946	1945
Current earnings	150,385	142,209
Current expenses	57,235	48,717
Current net earnings	93,150	93,492
Net deductions from current net earnings	626	830
Net earnings	92,524	92,662
Paid U. S. Treasury (Sec. 13b)	67	248
Dividends paid	10,962	10,182
Transferred to surplus (Sec. 13b)	28	262
Transferred to surplus (Sec. 7)	81,467	81,970
Total	92,524	92,662

with 142 million in 1945. Current expenses increased by about the same amount, 8 million dollars, so that net earnings were approximately equal to those in 1945. After payments totaling 11 million dollars for the dividend to member banks as provided in the Federal Reserve Act and payments to the United States Treasury under Section 13b of the Act relating to industrial loans, 81 million was added to the surplus of the Reserve Banks.

Foreign transactions. In the first full calendar year since V-J Day, considerable progress was made in the return of the System's foreign transactions to a peacetime basis. A number of foreign central bank accounts which had been closed or become dormant during the war were reopened, and conversely many of the foreign government accounts which had been set up as a wartime measure were closed. In addition to the reactivated accounts, five new foreign accounts were opened in 1946.

There was a further reduction in the total amount of assets held at the Federal Reserve Bank of New York for foreign central banks and governments, reflecting in part heavy postwar expenditures in this country, and in part repatriation of gold held under earmark. At the end of the year foreign-owned dollar deposits, earmarked gold, and securities held for all accounts, including accounts maintained by foreign depositors with the Federal Reserve Bank of New York acting as fiscal agent of the United States, amounted to 5,330 million dollars, as compared with 6,830 million at the end of 1945. There was, however, a noticeable increase in the total volume of foreign transactions handled by the Federal Reserve Bank of New York, despite a further curtailment in operations on behalf of United States departments and agencies. Investment transactions for foreign accounts during the year included not only substantial operations in United States Government securities, as in the past, but also (for the first time since 1939) some small purchases for a number of foreign central banks of prime endorsed bankers' acceptances.

Another operation in which there was a considerable increase in volume during the year was the granting of loans to foreign central banks by the Federal Reserve Banks against gold held under earmark at the Federal Reserve Bank of New York. Unlike long-term reconstruction loans of the type that has been made by the Export-Import Bank and is expected to be made by the International Bank for Reconstruction and Development, gold loans made by the Federal Reserve Banks are of a short-term nature and designed to meet temporary deficiencies in a foreign country's balance of international payments. Interest was charged on such loans at the rate of one per cent per annum.

The largest loan arrangement during the year was one with a European central bank, under which a series of short-term advances was made, the largest amount outstanding at any one time under this arrangement having been in excess of 100 million dollars. Three Latin American central banks and another European central bank also availed themselves of this facility in smaller amounts. At the end of the year a total of nearly 150 million dollars of gold-secured loans to foreign central banks was outstanding.

The Federal Reserve Bank of New York, as fiscal agent of the United States, continued to operate the United States Exchange Stabilization Fund under authorizations and instructions from the Treasury Department. All Federal Reserve Banks continued to act as agents for the Treasury in the administration of foreign funds control until February 1946, when the work was concentrated in the Federal Reserve Banks of New York, Chicago, and San Francisco. At the end of the year, all such operations were turned over to the New York Reserve Bank. In addition, the Federal Reserve Banks, acting under the Executive Order of January 15, 1934, and Treasury regulations, continued to collect and analyze reports from banks, security brokers and dealers, and others on international movements of capital.

Pursuant to the Bretton Woods Agreements Act, the Federal Reserve Bank of New York was appointed depositary of the International Monetary Fund and of the International Bank for Reconstruction and Development. In June 1946, the New York Reserve Bank was authorized by the Treasury to act as fiscal agent for the Export-Import Bank in connection with a 200 million dollar loan granted by the latter to The Netherlands Government and subsequently participated in by some 40 commercial banks in the amount of nearly 100 million dollars. Pursuant to this authorization, the New York Reserve Bank, and the other Reserve Banks through it, set up the necessary procedures for such participation.

Bank premises. With the decline during 1946 in the fiscal agency operations of the Federal Reserve Banks, it became possible at certain Banks and branches to relinquish some of the outside space being rented, thus reversing the trend throughout the war years. As stated in the *Annual Report* for 1945, it appears that most of the Federal Reserve Banks and branches will have to continue to rent outside space until such time as they can make additions to their present inadequate quarters or, in some cases, erect new buildings. The policy of making only necessary repairs and alterations to buildings and deferring construction of additions or of new buildings remained in effect because of the continued shortage of manpower and materials. The Board advised the Federal Reserve Banks, however, that there was no objection to employing architects to make preliminary plans for future building construction. A site for a building to house the Portland Branch, which now occupies rented quarters, was acquired during the year.

RESERVE BANK PERSONNEL

Chairmen and Deputy Chairmen. One of the three Class C directors appointed by the Board of Governors for each Federal Reserve Bank is designated annually to serve as Chairman of the Board of Directors and as Federal Reserve Agent, and another Class C director is appointed annually as Deputy Chairman. A list of the Chairmen and Deputy Chairmen is shown on page 121.

The Chairmen and Deputy Chairmen at the Federal Reserve Banks were redesignated to serve as such for the year 1946, except for the following changes:

Henry I. Harriman, Director and Vice Chairman of the New England Power Association, Boston, Massachusetts, who had been a Class C director of the Federal Reserve Bank of Boston since March 12, 1938, was appointed Deputy Chairman for the year 1946.

Russell L. Dearmont, Chief Counsel for Trustee of the Missouri-Pacific Lines, St. Louis, Missouri, who was appointed a Class C director of the Federal Reserve Bank of St. Louis on December 7, 1945, was designated Chairman and Federal Reserve Agent for the year 1946.

Roger B. Shepard of Newport, Minnesota, who had been a Class C director of the Federal Reserve Bank of Minneapolis since December 28, 1939, and Deputy Chairman since March 11, 1940, was designated Chairman and Federal Reserve Agent for the year 1946.

W. D. Cochran of the W. D. Cochran Freight Lines, Iron Mountain, Michigan, who had been a Class C director of the Federal Reserve Bank of Minneapolis since January 28, 1939, was appointed Deputy Chairman for the year 1946.

J. R. Parten, President of the Woodley Petroleum Company, Houston, Texas, who had been a Class C director of the Federal Reserve Bank of Dallas and Deputy Chairman since January 1, 1944, was designated Chairman and Federal Reserve Agent for the year 1946.

R. B. Anderson, General Manager of the Waggoner Estate, Vernon, Texas, was appointed a Class C director of the Federal Reserve Bank of Dallas for the term beginning January 1, 1946, and Deputy Chairman for the year 1946.

Directors. A list of the directors of the Federal Reserve Banks and branches as of the close of the year is shown on pages 122-29.

The Board made the following appointments of new directors either for terms beginning January 1, 1946, or to fill vacancies during the year:

Class C Directors. Donald K. David, Dean of the Graduate School of Business Administration of Harvard University, Cambridge, Massachusetts, was appointed a Class C director of the Federal Reserve Bank of Boston for the term beginning January 1, 1946.

J. P. Redman of Cairo, Illinois, was appointed a Class C director of the Federal Reserve Bank of St. Louis on September 20. Mr. Redman is engaged in farming.

Paul E. Miller, Director of the Agricultural Extension Division of the University of Minnesota, Minneapolis, Minnesota, was appointed a Class C director of the Federal Reserve Bank of Minneapolis for the term beginning January 1, 1946.

Branch Directors. Carl G. Wooster of Union Hill, New York, was appointed a director of the Buffalo Branch of the Federal Reserve Bank of New York for the term beginning January 1, 1946. Mr. Wooster is engaged in farming.

Albert H. Burchfield, Jr., Vice President of the Joseph Horne Company, Pittsburgh, Pennsylvania, was appointed a director of the Pittsburgh Branch of the Federal Reserve Bank of Cleveland for the term beginning January 1, 1946.

J. M. Koch, Vice President and Director of the Quaker State Oil Refining Corporation, Oil City, Pennsylvania, was appointed a director of the Pittsburgh Branch of the Federal Reserve Bank of Cleveland on November 18.

James E. Hooper, Vice President of William E. Hooper and Sons Company, Baltimore, Maryland, was appointed a director of the Baltimore Branch of the Federal Reserve Bank of Richmond for the term beginning January 1, 1946.

R. Flake Shaw, Executive Secretary of the North Carolina Farm Bureau Federation, Greensboro, North Carolina, was appointed a director of the Charlotte Branch of the Federal Reserve Bank of Richmond for the term beginning January 1, 1946.

John C. Curry, Administrative Assistant to Algernon Blair, Contractor, Montgomery, Alabama, was appointed a director of the Birmingham Branch of the Federal Reserve Bank of Atlanta on August 2.

H. C. Meacham of Franklin, Tennessee, was appointed a director of the Nashville Branch of the Federal Reserve Bank of Atlanta on February 14. Mr. Meacham is engaged in farming.

H. G. Chalkley, Jr., President of The Sweet Lake Land and Oil Company, Inc., Lake Charles, Louisiana, was appointed a director of the New Orleans Branch of the Federal Reserve Bank of Atlanta on January 3. Mr. Chalkley was serving as a director of the New Orleans Branch in 1941, when he was called to active duty as an officer in the Navy.

D. P. Cameron, President, The Merchants Company, Hattiesburg, Mississippi, was appointed a director of the New Orleans Branch of the Federal Reserve Bank of Atlanta on August 6.

Prentiss M. Brown, Chairman of the Detroit Edison Company, Detroit, Michigan, was appointed a director of the Detroit Branch of the Federal Reserve Bank of Chicago for the term beginning January 1, 1946.

Cecil C. Cox of Stuttgart, Arkansas, was appointed a director of the Little Rock Branch of the Federal Reserve Bank of St. Louis for the term beginning January 1, 1946. Mr. Cox is engaged in farming.

Leslie M. Stratton, Jr., Executive Vice President of the Stratton-Warren Hardware Company, Memphis, Tennessee, was appointed a director of the Memphis Branch of the Federal Reserve Bank of St. Louis for the term beginning January 1, 1946.

Fred S. Wallace of Gibbon, Nebraska, was appointed a director of the Omaha Branch of the Federal Reserve Bank of Kansas City on November 1. Mr. Wallace is engaged in farming.

Dorrance D. Roderick, President of the Newspaper Printing Corporation, El Paso, Texas, was appointed a director of the El Paso Branch of the Federal Reserve Bank of Dallas for the term beginning January 1, 1946.

Ross Stewart, General Manager of C. Jim Stewart and Stevenson, Houston, Texas, was appointed a director of the Houston Branch of the Federal Reserve Bank of Dallas on January 29.

H. P. Drought, an attorney of San Antonio, Texas, was appointed a director of the San Antonio Branch of the Federal Reserve Bank of Dallas on November 6.

Fred G. Sherrill, Vice President of the J. G. Boswell Company, Los Angeles, California, was appointed a director of the Los Angeles Branch of the Federal Reserve Bank of San Francisco on April 4.

Aaron M. Frank, President of the Meier and Frank Company, Inc., Portland, Oregon, was appointed a director of the Portland Branch of the Federal Reserve Bank of San Francisco on April 5.

John T. Tenneson, President, Superior Packing Company, Seattle, Washington, was appointed a director of the Seattle Branch of the Federal Reserve Bank of San Francisco on March 7.

Changes in Presidents and First Vice Presidents. Ralph E. Flanders, who had reached retirement age under the retirement plan, resigned as President of the Federal Reserve Bank of Boston and was succeeded by Laurence F. Whittemore, effective March 1, 1946. Mr. Whittemore was formerly Assistant to President of the Boston and Maine Railroad and a Class B director of the Federal Reserve Bank of Boston.

Ira Clerk, who had been an officer of the Federal Reserve Bank of San Francisco since its organization in November 1914, and President since January 1, 1946, died on September 28, 1946. Mr. Clerk was succeeded as President by C. E. Earhart. Mr. Earhart has been with the Bank since 1917, has served as an officer since 1920, and as First Vice President since January 1, 1946.

Frank J. Drinnen, who had been associated with the Federal Reserve System since 1919, and had served as First Vice President of the Federal Reserve Bank of Philadelphia since 1936, resigned effective February 28, 1946. Mr. Drinnen was succeeded by W. J. Davis as First Vice President. Mr. Davis has been an officer of the Bank since 1917.

Malcolm H. Bryan, who had been First Vice President of the Federal Reserve Bank of Atlanta since May 15, 1941, resigned effective October 18, 1946, to become associated with the Trust Company of Georgia. Mr. Bryan was succeeded as First Vice President by L. M. Clark. Mr. Clark has been a member of the Bank's staff since 1918, and has served as an officer since 1930.

Staff. At the end of 1946 the total number of officers and employees of the twelve Federal Reserve Banks and their twenty-four branches was 21,430, representing a decline of 2,092 since the end of 1945. This was the third successive year of decline following several successive years of increase due to the great expansion in the volume of operations during the war years. The total number of officers and employees of the Reserve Banks and branches at the end of each year beginning with 1939 was as follows:

1939	11,355	1943	24,741
1940	11,640	1944	24,442
1941	14,083	1945	23,522
1942	19,972	1946	21,430

BOARD OF GOVERNORS—STAFF AND EXPENDITURES

Appointment of Board Member. The appointment of Commodore James K. Vardaman, Jr., as a member of the Board of Governors for the term ending January 31, 1960, was approved by the Senate on April 3, 1946, and he assumed his duties as a member of the Board on April 4. Commodore Vardaman succeeded Mr. John K. McKee, whose term expired January 31, 1946, but who under the law continued to serve until April 2, 1946.

Staff. On December 31, 1946, the Board's staff, exclusive of those on military leave or leave without pay, numbered 480, as compared with 455 at the end of 1945.

During the year 25 of the Board's permanent employees who had been on military leave rejoined the staff: 19 elected not to return after their discharge from military service, and only 4 employees who had entered military service were still on leave at the end of the year.

Howard S. Ellis resigned as Assistant Director of the Division of Research and Statistics, effective January 20, 1946, to return to his position as Professor of Economics at the University of California. Mr. Ellis had been on leave of absence from the University since he joined the Board's staff in September 1943, as an Economic Specialist. He was appointed Assistant Director of the Division of Research and Statistics, effective February 1, 1945.

Ralph A. Young was appointed an Assistant Director of the Division of Research and Statistics and assumed his new duties on March 20, 1946. Mr. Young had for some time been serving on the staff of the National Bureau of Economic Research in connection with its financial research program and also as Professor of Economics at the University of Pennsylvania.

J. Burke Knapp was appointed an Assistant Director of the Division of Research and Statistics effective June 1, 1946. Mr. Knapp was associated with the Board's Division of Research and Statistics from February 1940 to August 1944, when he resigned to accept a position with the Department of State. He returned to the Board in October 1945, and was serving in the capacity of Special Assistant to the Chairman on International Finance at the time of his appointment as Assistant Director of the Division of Research and Statistics.

Walter Wyatt, who had been a member of the Board's staff since 1917, and its General Counsel since 1922, resigned effective February 28, 1946 to accept the position of Reporter of Decisions for the Supreme Court of the United States, effective March 1, 1946.

The designation of George B. Vest was changed from General Attorney to General Counsel, and that of J. Leonard Townsend from Assistant General Attorney to Assistant General Counsel, effective March 1, 1946.

David M. Kennedy was appointed Special Assistant to the Chairman effective June 1, 1946. Mr. Kennedy was originally employed in the Board's Division of Bank Operations in April 1930, and became associated with the Board's Division of Research and Statistics in May 1941. Immediately prior to his appointment as Special Assistant to the Chairman he was serving in the capacity of Assistant Chief of the Government Securities Section. Mr. Kennedy resigned in October to become associated with the Continental Illinois National Bank and Trust Company of Chicago.

Leo H. Paulger, who had been Director of the Division of Examinations since January 16, 1932, was appointed Special Adviser to the Board of Governors, effective August 1, 1946.

Robert F. Leonard, who had been Director of the Division of Personnel Administration, was appointed Director of the Division of Examinations, effective August 1, 1946.

C. E. Cagle, who had joined the Board's staff as a Federal Reserve Examiner on February 1, 1933 and who had been an Assistant Director of the Division of Examinations since May 1, 1935, resigned effective October 31, to return to private enterprise.

Edwin R. Millard and George S. Sloan were appointed Assistant Directors of the Division of Examinations, effective November 1. Mr. Millard had been a Federal Reserve Examiner since 1932, and the Examiner in charge of the field force since 1941. Mr. Sloan had been a Federal Reserve Examiner since June 1934.

Fred A. Nelson, who had been Assistant Director of the Division of Administrative Services, was appointed Director of the Division of Personnel Administration, effective August 1, 1946.

Gardner L. Boothe, II, who had been Assistant Administrator for War Loans, was appointed Assistant Director of the Division of Administrative Services, effective August 9, 1946.

Merritt Sherman was appointed an Assistant Secretary of the Board, effective October 1, 1946. Mr. Sherman had been with the Federal Reserve Bank of San Francisco since September 1926, and had been an officer of the Bank since May 1, 1941.

Change in Board's organization. Effective August 20, 1946, the Board of Governors abolished its Office of Administrator for War Loans, and transferred the functions and duties remaining in that office to the Division of Bank Operations.

Expenditures. The current expenses of the Board for the year 1946 aggregated $2,405,676. Two assessments were levied on the Federal Reserve Banks, representing about four-tenths of one per cent of their average paid-in capital and surplus for the year, to cover the general expenses of the Board. Details are shown in the following table:

RECEIPTS AND DISBURSEMENTS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR THE YEAR 1946

General fund account:				
Balance January 1, 1946:				
For general expenses of the Board			$602,973.57	
For expenses chargeable to Federal Reserve Banks			266,242.24	
For purchase of United States Savings Bonds for employees under Board's Voluntary Pay Roll Savings Plan			10,428.75	
For income tax withholdings due Collector of Internal Revenue			60,525.10	$940,169.66
RECEIPTS				
For general expenses of the Board:				
Assessments on Federal Reserve Banks for estimated general expenses of the Board		$2,259,783.78		
Subscriptions to the Federal Reserve Bulletin		11,157.84		
Other publications, sales		9,551.50		
Reimbursements for leased wire service		47,226.99		
Cafeteria operations		55,305.92		
Miscellaneous receipts, refunds, and reimbursements		13,316.85	2,396,342.88	
For expenses chargeable to Federal Reserve Banks:				
Assessments on Federal Reserve Banks for:				
Cost of printing Federal Reserve notes		2,871,193.55		
Expenses of leased wire system (telegraph)		58,915.12		
Expenses of leased telephone lines		9,212.44		
Expenses of Federal Reserve Issue and Redemption Division (Office of the Comptroller of the Currency)		60,656.93		
Miscellaneous expenses		2,931.68	3,002,909.72	
Employees' pay roll allotments for purchase of United States Savings Bonds			149,692.50	
Income tax withheld from salaries			243,175.08	
Total receipts				5,792,120.18
Total available for disbursement				6,732,289.84
DISBURSEMENTS				
For expenses of the Board:				
Current expenses of 1946 (per detailed statement)	$2,405,675.68			
Less accounts unpaid December 31, 1946	144,870.89	2,260,804.79		
Expenses of prior years paid in 1946		143,195.68		
Expenses of leased wire service, reimbursable		47,127.64		
Retirement System (salary computation adjustment)		13,104.00		
Cafeteria operations		50,915.96		
Miscellaneous disbursements, refunds and items reimbursable		18,764.42	2,533,912.49	
For expenses chargeable to Federal Reserve Banks:				
Cost of printing Federal Reserve notes		2,987,772.25		
Expenses of leased wire system (telegraph)		57,440.74		
Expenses of leased telephone lines		10,519.94		
Expenses of Federal Reserve Issue and Redemption Division (Office of the Comptroller of the Currency)		60,656.93		
Miscellaneous expenses		5,271.09	3,121,660.95	
Purchase of United States Savings Bonds and refunds under Board's pay roll plan			153,728.50	
Collector of Internal Revenue—income tax withheld from salaries			243,205.54	
Total disbursements				6,052,507.48
Balance in general fund account December 31, 1946:				
For general expenses of the Board			465,403.96	
For expenses chargeable to Federal Reserve Banks			147,491.01	
For purchase of United States Savings Bonds for employees under Board's Voluntary Pay Roll Savings Plan			6,392.75	
For income tax withholdings due Collector of Internal Revenue			60,494.64	
				$ 679,782.36

RECEIPTS AND DISBURSEMENTS—*Continued*

CURRENT EXPENSES

Personal services:		
Salaries		$1,777,629.12
Retirement contributions		152,917.85
Total personal services		$1,930,546.97
Nonpersonal services:		
Traveling expenses		124,508.27
Postage and expressage		18,362.30
Telephone and telegraph		47,995.60
Printing and binding		95,884.78
Stationery and supplies		15,541.81
Furniture and equipment		16,536.89
Books and subscriptions		7,758.72
Heat, light and power		26,398.58
Repairs and alterations (building and grounds)		15,552.02
Repairs and maintenance (furniture and equipment)		3,619.73
Medical service and supplies		1,003.20
Insurance		6,001.97
Miscellaneous:		
Cafeteria operations	$25,726.52	
Liquid assets survey	52,500.00	
All other	17,738.32	95,964.84
Total nonpersonal services		$475,128.71
GRAND TOTAL		$2,405,675.68

Under an arrangement with the Federal Reserve Bank of New York, the accounts of the Board for the year 1946 were audited by the Auditor of the Bank, who certified them to be correct.

RESEARCH AND ADVISORY SERVICES

Changes in the Board's research activities during 1946 were designed to facilitate current analysis of immediate postwar developments and to permit more extended study of basic economic conditions, which were altered in many important respects during the war. Current developments in the field of Treasury financing, bank credit, the labor and commodity markets, and international finance continued to receive close attention. The data for current analyses in the field of business finance and the procedures for making projections of the gross national product and related factors were further developed. Some of the regular statistical series were revised, including those on department store stocks. Progress was also made in revising certain of the component series in the Federal Reserve index of industrial production. In addition, a number of special investigations were initiated, primarily for the purpose of improving information concerning wartime changes in the conditions affecting the availability and use of money and credit.

In order to provide information concerning contemporary lending activities of banks, the Board of Governors and the Reserve Banks conducted a sample survey of member bank loans to commercial and industrial concerns outstanding as of November 20, 1946. The survey provided comprehensive information on the characteristics of outstanding bank loans to business borrowers and on the structure of the business credit market. The facts when analyzed and presented in 1947 will be useful to the Reserve System in considering credit policies that will contribute to the maintenance of high levels of economic activity. In addition, the information should be helpful to banks in reviewing their loan policies, with long-run objectives in mind, as well as to others interested in the availability of bank credit for business purposes. A similar survey of agricultural loans by commercial banks, to be conducted in cooperation with the Federal Deposit Insurance Corporation, has also been projected for 1947.

Another special feature of the Board's research program during the year was a national survey of liquid asset holdings, savings, incomes, and expectations of individual consumer units, carried out under special arrangement by the Division of Program Surveys of the Bureau of Agricultural Economics, Department of Agriculture. The results of this survey, which were presented in the *Federal Reserve Bulletin* and are summarized briefly elsewhere in this report, aroused widespread interest and comment and were particularly relevant to current problems of bank credit and monetary policy. Because of the value of the 1946 survey, not only to the Board and various Government agencies, but also to others in illuminating matters of broad public interest, the Board authorized a second nation-wide survey of consumer finances, to be made by the Survey Research Center of the University of Michigan. The 1947 survey, which was planned in cooperation with interested Government agencies, is being conducted in the same manner as in 1946, but coverage includes some data on nonliquid assets in addition to information similar to that obtained in 1946. Studies of this type are still in an experimental stage of development, and one important contribution of a second survey will be to provide a test of some of the major findings of the first survey.

Studies in the field of business finance on the basis of data from financial statements of manufacturing and trade concerns, obtained in part through a cooperative survey with the Robert Morris Associates, were continued.

Over the past two years the Board's staff has cooperated in the planning and conduct of an exploratory study to trace the flow of money payments through major sectors of the economy. The study has been conducted by the National Bureau of Economic Research at the suggestion of, and under a grant of funds from, the Committee for Economic Development. Preliminary results of the exploratory work covering a selected historical period have demonstrated the feasibility of the undertaking, and the Board has authorized a special project to construct money flow measurements on a current basis. This activity will build upon the statistical work begun under the National Bureau's auspices and will also undertake to extend the scope of the investigation of the flow of money.

In the international field extensive demands were made upon the Board's staff, especially in connection with the work of the National Advisory Council on International Monetary and Financial Problems, of which the Chairman of the Board is a member. The Staff Committee of the Council assures coordination of research work in the various member agencies on current international financial problems. Members of the Board's staff also served as technical advisers to the United States Governor of the International Fund and Bank during the two meetings of the Boards of Governors of those institutions which took place during the year. Library and other research facilities and assistance were made available to the newly organized research departments of the Fund and the Bank following their establishment in Washington, and two members of the Board's staff were lent temporarily to the International Bank to assist in developing a system of accounting control.

Representatives of the Federal Reserve System participated in a conference on economic and statistical methods held in Mexico City in August, to which the Bank of Mexico invited representatives from all central banks of the Western Hemisphere. This conference afforded the participants an opportunity to become better acquainted with general economic conditions in other countries of the Western Hemisphere and to exchange views on the monetary and banking problems of their respective countries and of the Hemisphere as a whole.

Members of the Board's staff continued collaboration on new monetary and banking legislation in several Latin American countries undertaken at the request of those countries and of the State Department. These advisory services were made available to the Dominican Republic and Guatemala. The services of members of the staff were also made available to the Military Government authorities in Germany and Korea.

The Board had numerous visitors from foreign central banks and governments, some of whom were making extended tours in the United States for consultation with Government officials and observation of American administrative, supervisory, and research methods. The Board made facilities for study available to students from foreign central banks and governments who were pursuing studies in the United States.

PUBLICATIONS AND RELEASES

During the year 1946 there was a growing demand for material issued by the Board. Increased enrollments in schools and colleges resulted in greater use of the Board's publications for classroom purposes; and the resumption of more normal foreign mail service brought about additional requests for both current publications and those issued during the war period. The publications listed below were issued during the year and several periodic releases were initiated.

Federal Reserve Bulletin. Issued monthly.

Member Bank Call Report. Three issues, one each in April, October, and December.

Par List, and list of State Bank Members of the Federal Reserve System and Nonmember Banks That Maintain Clearing Accounts

WITH FEDERAL RESERVE BANKS. Complete lists released in October and January, respectively, with supplements in other months.

LIST OF STOCKS REGISTERED ON NATIONAL SECURITIES EXCHANGES. Published in February with quarterly supplements in May, August, and November.

FEDERAL RESERVE CHARTS ON BANK CREDIT, MONEY RATES, AND BUSINESS. Revised edition published in March.

PRICES, WAGES, AND EMPLOYMENT (Postwar Economic Studies No. 4). Published in July.

PRIVATE CAPITAL REQUIREMENTS (Postwar Economic Studies No. 5). Published in October.

HOUSING, SOCIAL SECURITY, AND PUBLIC WORKS (Postwar Economic Studies No. 6). Published in August.

RETAIL CREDIT SURVEY—1945. Published in August.

MONETARY AND BANKING REFORM IN PARAGUAY. Published in August.

RULES OF ORGANIZATION AND RULES OF PROCEDURE (Board of Governors). Published in September.

FEDERAL RESERVE ACT AS AMENDED TO NOVEMBER 1, 1946. Published in November.

FEDERAL RESERVE MEETINGS

The Federal Open Market Committee met in Washington on February 28, March 1, June 10, and October 3, 1946, and the executive committee of the full Committee met from time to time during the year. Under the provisions of Section 12A of the Federal Reserve Act, the Federal Open Market Committee has responsibility for determining the policies under which the open market operations of the Reserve Banks will be carried out. A record of the actions taken by the Committee on questions of policy will be found on pages 101-04 of this report.

A Conference of the Chairmen of the Federal Reserve Banks was held on December 5 and 6, 1946, and was attended by members of the Board of Governors.

The Conference of Presidents of the Federal Reserve Banks held meetings on February 25-26, June 7-8, and October 1-2, 1946, and the Board of Governors met with the Presidents on February 28, June 11, and October 4.

Meetings of the Federal Advisory Council were held on February 17-18, May 19-20, October 6-7, and December 1-3, 1946, and the executive committee of the Council met on April 24, June 26, and November 6. The Board of Governors met with the Council or its executive committee on each of these occasions. The Council is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve

Act to consult with and advise the Board on all matters within the jurisdiction of the Board.

During the year several conferences, attended by representatives of the Federal Reserve Banks and the Board of Governors, were held to discuss questions relating to international monetary and credit matters, research and credit problems and policy, examinations, fiscal agency functions, Federal Reserve Bank collection systems, functional expense reports, bank and public relations, the personnel of the Federal Reserve Banks, and the Board's consumer credit regulations.

ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Inflationary forces continued to dominate the nation's economy during 1947 and the early months of 1948. Monetary and fiscal policies were directed toward reducing the influence of credit expansion in furthering inflation. In view of the wartime growth of the public debt, however, and the responsibility of the Federal Reserve System for maintaining an orderly market for Government securities, the Federal Reserve authorities were unable to make use of established instruments to restrain credit expansion to the extent that was previously possible. Accordingly, the Board of Governors recommended to the Congress the adoption of legislation that would restore to the System the power to impose more effective restraints.

Total demand by consumers, businesses, and government, based on rising incomes, on the use of previously accumulated savings, and on new borrowing, exceeded the capacity of the economy to supply goods and services. Aggregate output, which at the beginning of 1947 was larger than in any previous peacetime period, showed little further growth in the course of the year. Prices rose under the pressure of vigorous demands, and the total value of the nation's product of goods and services continued to increase. Employment was close to the maximum level possible with the existing labor force. The large volume of employment, rising wage rates, high prices for farm products, and large profits by businesses were reflected in a further growth of national income.

Consumer expenditures, which had necessarily been less than income during the war period because of the scarcity of goods available for purchase and the effect of rationing and price controls, increased after the war more rapidly than personal incomes. This reflected the increased availability of goods and the willingness of many consumers to spend freely notwithstanding sharply advanced prices. Many consumers drew upon their large wartime accumulations of savings and others borrowed to supplement current incomes. Although current personal savings were considerably below the abnormally high wartime level, individuals in the aggregate continued to add to their holdings of liquid assets.

Heavy business expenditures for equipment, plant, and inventories, prompted by expanding markets and increased earnings, added to the total volume of buying. Farmers, with incomes at record high levels, were likewise active buyers of equipment, as well as of consumers' goods. There was also a sharp expansion in expenditures of State and local governments. Growing domestic expenditures were reinforced by exceptionally active demand for American goods from abroad, reflecting acute needs on the part of war-ravaged Europe and large purchasing power on the part of other countries.

Expenditures by the Federal Government in 1947 were an important factor in total demand, as measured by peacetime standards, although somewhat smaller than in 1946. At the same time, Government cash receipts exceeded cash payments, and a substantial amount of Government securities was retired, particularly of bank-held securities. These fiscal and debt-management developments had an anti-inflationary impact. They not only withdrew funds from current incomes of businesses and individuals and thereby reduced amounts available for spending; they also had the effect of withdrawing reserves from banks, thereby making it necessary for many banks to liquidate Government securities in order to maintain their reserve positions and at the same time meet the growing demand for loans.

Increased expenditures by businesses and by State and local governments were financed in part by a large volume of security offerings for new money and a rapid expansion of bank loans. Growing investment in housing resulted in an expansion of mortgage loans, and consumer credit also increased substantially.

Vigorous and widespread bank credit demand in 1947 stemmed largely from forces accompanying the high level of economic activity and sharply rising prices. Some of the loans extended by banks facilitated expansion in production of goods and services but, since there was little over-all increase in the total volume of output, the additional money supplied by increases in bank loans was an important inflationary factor. Some of the funds made available through bank loans were used by businesses to bid for scarce materials and manpower or by consumers to swell the demand for limited supplies of goods and services. Thus by borrowing from banks some producers were able to bid away productive resources from others, who in turn were induced by active business conditions to seek additional credit with which to protect their own operations. Similarly, borrowing by consumers was a factor in the rising prices of many consumer items. Some borrowers, moreover, encouraged by inflationary price advances, sought bank loans to purchase and withhold supplies from the market. Loans of this type retarded production and stimulated price advances.

In summary, inflationary developments, which had begun because of wartime shortages of goods in relation to income, were carried forward through 1947 by a rising spiral of costs, prices, and incomes, supported by use of past savings and by substantial credit expansion. With additions to the supply of domestic goods limited, with supplies from abroad still small and needs large, with the economy's total expenditures increasing, and with an already abundant money supply and capacity for further credit expansion, the threat of further inflation continued into 1948.

MONETARY POLICY IN 1947

Policies pursued by the Federal Reserve authorities since 1946, together with measures adopted by the Treasury in connection with management of the public debt, have been designed to absorb bank deposits and bank reserves and to restrain further over-all monetary expansion. With a vigorous demand for loans on the part of nearly all groups of borrowers and with decreases in net earnings, banks have been under pressure to expand their loans. Funds to meet current demands for credit have been made available by the large inflow of gold or have been readily obtainable by banks through selling some part of their greatly expanded holdings of Government securities. Reserves have also been supplied more recently through sales of Government securities by nonbank investors. In the absence of other buyers, a large portion of the securities offered for sale have been purchased by the Federal Reserve Banks in accordance with the System's policy of maintaining an orderly and stable market for the vast volume of Government securities outstanding.

Effective limitations on credit expansion could be accomplished only by absorption of bank reserves through a reduction in Federal Reserve holdings of Government securities or by voluntary restraint on the part of borrowers and lenders. Since banks, and at times during the year other investors as well, were selling Government securities on balance in order to obtain funds for other purposes, it was not possible for the Reserve System to reduce its holdings to the extent necessary. In any event, a vigorous attempt to do so would have brought about disorderly conditions in the market for Government securities with widespread repercussions throughout the economy.

Some restraint was effected through the use of an excess of Treasury cash receipts over expenditures to retire Government securities held by the Federal Reserve Banks. This excess, which reflected not only a small surplus in budget accounts but also receipts for Government trust accounts invested in special issues and sales of new issues of nonmarketable securities in excess of redemptions, represented the balance of funds being withdrawn from banks by Treasury transactions. When used to retire securities held by the Reserve Banks, these funds are not returned to the market, as they would be if used to retire securities held by others.

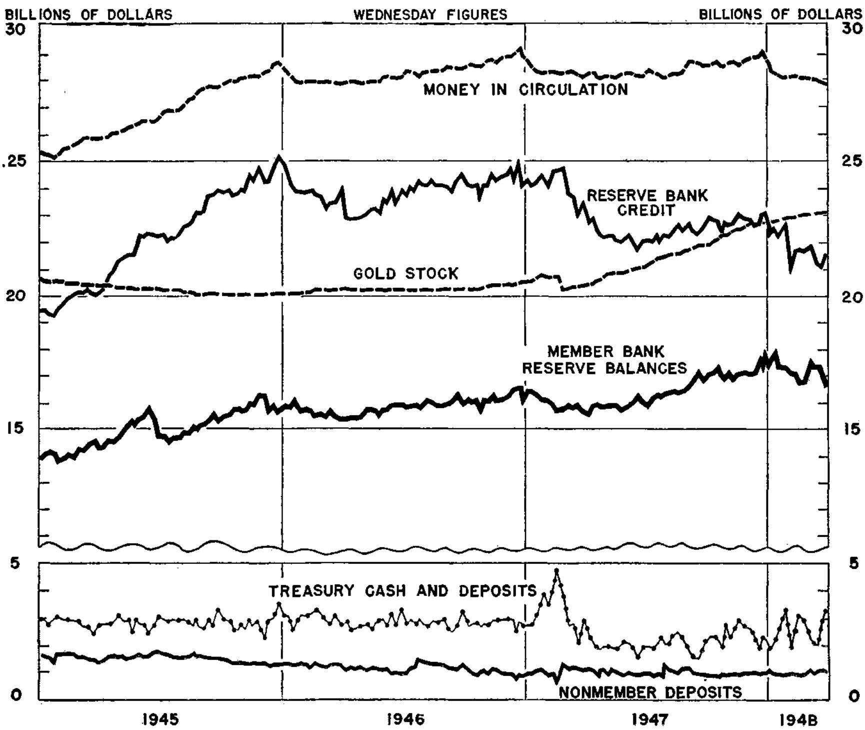
Banks losing funds through these transactions had to sell Government securities in order to maintain their reserve positions, and particularly to expand loans. These securities, if not taken by other buyers, were purchased by the Federal Reserve Banks, which thereby made additional reserves available to banks. Even though securities were readily salable by banks, the need to sell securities to adjust reserve positions and make loans was a factor of restraint on credit expansion by some banks.

During the early months of 1947, banks obtained reserves from the gold inflow and a seasonal return of currency from circulation. Although the

Treasury had a large excess of cash receipts over expenditures, much of this excess was returned to the banks through substantial retirement of securities held by commercial banks and other holders. In this period, therefore, banks were able to meet substantial losses of deposits and also expand their loans.

In the second quarter of the year, a larger portion of debt retirements were of securities held by Federal Reserve Banks, including a portion of the weekly issues of Treasury bills. These operations utilized Treasury balances accumulated during the first quarter in a manner that did not add to reserves. Bank reserves were increased, however, by the gold inflow, as is shown in the accompanying chart, and bank loans and deposits increased.

MEMBER BANK RESERVES,
RESERVE BANK CREDIT, AND RELATED ITEMS

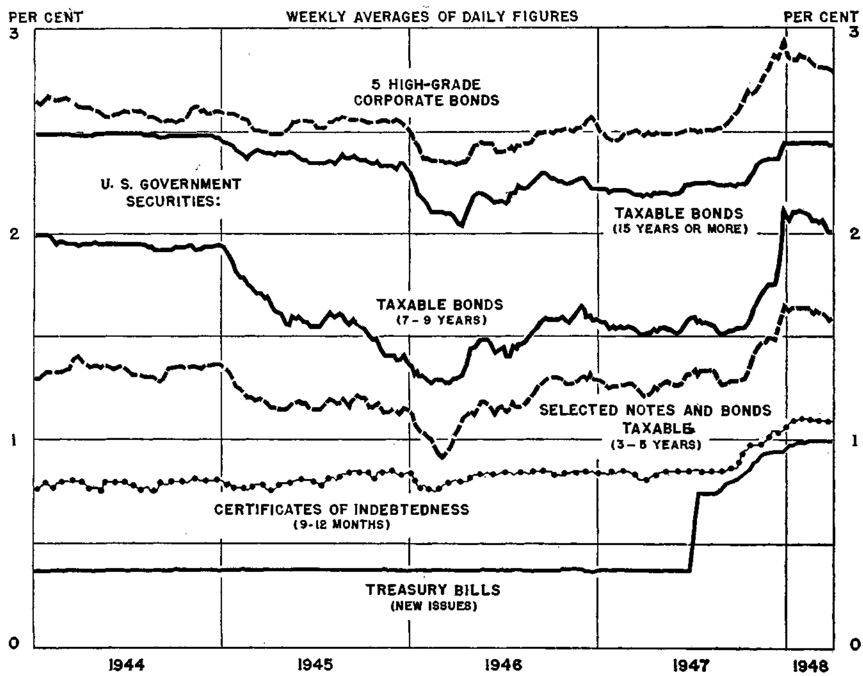


In the middle part of the year, there was a strong demand for Government bonds on the part of banks and other investors. The Treasury sold substantial amounts of marketable bonds from Government trust funds to meet some of this demand. These sales withdrew funds from the banks which were used to retire maturing debt. There was a growth in the total of bank loans and investments and, notwithstanding the continued gold inflow, banks sold certificates to the Federal Reserve in order to obtain additional reserves.

Beginning in July the Federal Reserve System and the Treasury adopted measures to permit some rise in interest rates on short-term Government securities in order to increase their attractiveness to banks and other investors and to place an additional restraint on further monetary expansion. The System discontinued its buying rate on Treasury bills, which had been fixed at 3/8 per cent since 1942. The rate on bills rose during the remainder of the year to nearly 1 per cent, as is shown in the chart. The length of term to maturity of newly offered Treasury certificates was shortened in August and September and subsequently higher issuing rates were placed on new issues; these rates rose from 7/8 per cent to 1 1/8 per cent by the end of the year.

In October the Treasury sold to institutional investors a 2 1/2 per cent long-term, nonmarketable bond, redeemable at a discount prior to maturity. This issue, together with sales of marketable securities from Government trust funds, absorbed funds seeking investment. After October Federal Reserve holdings of maturing securities other than bills were paid off in full. In this way the Treasury excess of cash receipts was withdrawn from the market and not put back, thereby exerting a maximum of pressure on the reserve position of banks.

YIELDS ON TREASURY AND CORPORATE SECURITIES



NOTE: Latest figures shown are for week ended Apr. 3, 1948. The Treasury series include all securities within the classes specified with the following exceptions: the 3–5 year series and, since Dec. 15, 1945, the 7–9 year series, include only selected issues. For data, see *Federal Reserve Bulletin* for April 1948, tables on p. 427.

These official measures, designed to restrict the supply of available funds, were accompanied by increased demand for bank credit and for investment funds. Offerings of corporate securities increased and those of State and local government issues continued in large volume; there was a growing demand for mortgage and consumer credit as well as for commercial loans. As a result, bank credit expanded sharply in the last half of 1947.

Growing demands for funds, coupled with measures to absorb the supply available for investment and to restrict credit extension, resulted in a rise in money rates and bond yields during the last half of 1947. In October this movement began to affect the Government bond market. During part of November and December, the Federal Reserve and the Treasury through limited purchases supported prices of Government bonds at the levels they had reached in the market, which were in most cases still substantially above par. On December 24 prices of Treasury bonds were permitted to decline to a new level, which maintained the 2½ per cent yield on the longest-term Treasury bond and yields on other issues at appropriate levels in relation to this rate and to the 1⅛ per cent rate on Treasury certificates. The Federal Reserve System became an active buyer at the new level.

Large amounts of Treasury bonds were purchased by the Reserve Banks during December 1947 and the early weeks of 1948 in providing support to the market. A substantial portion of these purchases were from insurance companies and other institutional investors and some were from banks. At the same time banks, as well as other investors, increased their holdings of Treasury bills, certificates, and notes. Since these were largely purchased from Federal Reserve accounts and since during the period the Treasury had a substantial cash surplus, which it continued to use to retire securities held by the Federal Reserve Banks, the total Federal Reserve portfolio of Government securities declined during the early weeks of 1948.

In the middle of January 1948, as a measure of restraint upon the use of Federal Reserve Bank credit, the Federal Reserve Banks increased their discount rates on advances to member banks from 1 to 1¼ per cent. The Board of Governors also took action late in January to increase from 20 to 22 per cent, effective February 27, 1948, the reserves required to be maintained against net demand deposits by member banks in central reserve cities (New York and Chicago). The requirement for banks in these cities had been at 20 per cent since the latter part of 1942, when it had been reduced from 26 per cent, the maximum permitted under existing law.

In view of the expanding volume of bank lending and the accompanying inflationary developments, the Federal and State bank-supervisory agencies issued in November a joint statement urging banks to curtail speculative loans, to guard against overextension of consumer credit, and to confine financing to loans which would help production and not merely increase consumer demand.

Toward the end of 1947 the American Bankers Association sponsored an organized effort by banking leaders to encourage voluntary restraint on inflationary bank credit extension among the country's 15,000 commercial banks. To the extent that individual banks restrict voluntarily their lending and investing programs, anti-inflationary monetary and supervisory policies pursued by the Federal Reserve System and the Treasury are reinforced and made more effective. Such voluntary action, to be effective in restricting credit expansion, requires the adoption by individual banks of rigid standards in all lending operations, with a view to preventing further expansion in the total volume of bank deposits as well as avoiding loans that may involve a high degree of risk.

INADEQUACY OF EXISTING MONETARY INSTRUMENTS

Since 1945 the Federal Reserve authorities have been confronted by a redundant money supply and demands on the part of banks for additional reserves to support further credit expansion. In this situation, which was largely created through the processes of war finance, the central problem of monetary policy has been to restrain further growth in bank credit, which would add to an already excessive supply of money and thereby increase postwar inflationary pressures. In view of the large volume and widespread distribution of Government securities, which can be sold to the Federal Reserve Banks, thereby creating additional bank reserves, and in view of the need for assuring support to the market for these securities, customary instruments of monetary policy have had only limited applicability to the restraint of credit expansion. Accordingly, in recent *Annual Reports* and in other public statements the Board has pointed out the present inadequacies of these instruments.

The commercial banks of the country hold nearly 70 billion dollars of Government securities, and others, excluding Government agencies and the Federal Reserve, hold another 70 billion of marketable issues that can be readily sold, not to mention some 60 billion of nonmarketable issues redeemable practically on demand. Substantial amounts of marketable issues are regularly being bought and sold in the market, and constant Federal Reserve operations are essential for the maintenance of an orderly market and reasonable stability of prices. In these circumstances, it is not possible for the System to confine its open market operations to meeting the economy's current needs for bank credit. To permit a gradual decline in prices of Government securities, moreover, might result in heavy liquidation of investor holdings.

Inflationary potentialities latent in the postwar monetary situation and limitations of the Reserve System's statutory powers for exerting an effective anti-inflationary influence under conditions brought about by the war were first pointed out in the Board's *Annual Report* for 1945. Developments since that time have emphasized the dilemma of the System in undertaking restrictive action within the existing framework of its authority while maintaining a responsibility for the orderliness and stability of the Government securities market. The Board believes that it would be unwise to set aside this responsibility in view of likely adverse effects on financial institutions, on the Government's fiscal and debt-management operations, and on the financial position of business.

After extensive study of the problem of bank credit restraints, the Board concluded that, in order to be in a position to meet further contingencies of inflationary bank credit expansion without abandoning support of the Government securities market, some workable addition to the System's existing authority may be needed, at least on a temporary basis. Rapid bank credit expansion during the second half of 1947 clearly indicated that existing restraints are not adequate for these objectives. In response to a request from committees of Congress, in a session called to consider emergency measures to aid European recovery and to cope with inflationary developments in the economy, the Chairman of the Board of Governors presented an analysis of the credit situation and the Board's proposal for legislation to permit the imposition of more effective restraints.

Strengthening of monetary policy to regulate over-all bank credit expansion in accordance with the economy's needs could be accomplished by legislation extending authority to increase the statutory reserve requirements of member banks and to require nonmember banks to hold additional reserves in an amount corresponding to the increase for member banks. In adjusting to higher reserve requirements, banks would be obliged to sell Government securities and thus to reduce their earning assets.

Late in 1940, the Board of Governors, the Presidents of the Federal Reserve Banks, and the Federal Advisory Council, in recognition of the inflationary dangers presented by imminent war, recommended to the Congress that additional authority to raise basic reserve requirements for member banks be granted to the Federal Reserve System and that nonmember banks be made subject to similar requirements. In its *Annual Reports* for 1945 and 1946, the Board again urged such an authority as a possible means of meeting the postwar problem of regulating the pace of monetary expansion.

Over the longer run, authority to vary the level of primary reserve requirements might well be adjusted to a revised basis of reserve requirements for individual banks. The present structure of reserve requirements is based on cities in which banks are located and traces back to the National Banking Act, under which banks in certain designated cities were authorized to hold the basic reserves of other banks. A new system of reserve requirements related to the type of deposit business which individual banks perform might be substituted for this outmoded set of standards. Under the new pattern all banks should be required to maintain the same amount of reserves against any one type of deposit and variations in requirements should be entirely in accordance with the type of deposit, e.g., interbank balances, other demand deposits, and savings deposits. This would greatly moderate the arbitrary inequities among banks which result from existing statutory requirements. In addition, vault cash should be made eligible as a reserve asset. The role of interbank balances in our banking system could be given greater recognition, but in such a way that shifts in correspondent balances would not affect the reserve position of the banking system as a whole.

An alternative solution to the current problem of restrictive monetary policy, which would not require banks to reduce their holdings of earning assets, would be a temporary special reserve authority along the lines proposed by the Board to the called session of the 80th Congress. Under this plan banks were not to be required to add to their reserve balances with Federal Reserve Banks, but would be permitted to hold as special reserves certain cash assets not now eligible as reserves for member banks, and in addition certain earning assets, namely, Treasury bills, certificates, and short-term notes. Specified cash assets in excess of existing reserve requirements and customary operating funds would be counted toward the special reserve, and an allowance of 20 per cent of demand deposits and 6 per cent of time deposits was proposed as an adequate allowance for these established banking needs. Maximum statutory limits of 25 per cent of gross demand deposits and 10 per cent of time deposits were suggested for the special reserve requirement.

Under this measure banks would be restricted as to the amount and types of securities they could sell to obtain additional reserves but would not have to reduce their total holdings of securities in order to meet the requirement. Most banks would probably find it unnecessary to make any adjustment in existing assets at the time of the initial imposition of the requirement. The authority would make it possible for the Federal Open Market Committee to require banks to immobilize a portion of their greatly expanded holdings of Government securities instead of permitting them to treat these holdings as excess reserves, which can be used at will to expand loans. The special reserve requirement could be adjusted by the Committee from time to time in accordance with changes in reserves resulting from gold or currency movements or from purchases or sales of Government securities by the Federal Reserve Banks.

The special requirement would not compel any bank to hold Government securities if it preferred to hold cash assets. It would, however, encourage the holding of short-term Government securities and help to maintain a stable market for such issues. The authority, by thus partially insulating a portion of the public debt, would make it possible to limit the volume and raise the cost of private credit without necessarily increasing the interest cost to the Government. It would not prevent banks from obtaining additional funds to meet deposit withdrawals or make essential loans, but would impose some restraint on credit expansion.

The Board believes that the proposed plan would be the most effective and practical method of dealing with the present monetary and credit situation because it could be used to exert pressures at the places where restraint on bank credit expansion is needed, namely, in the field of private loans. At the same time the plan would protect the interests of the Government, the general public, and the banking system.

Use of temporary authority to increase commercial bank reserve requirements, on the basis of either an extension of the existing pattern or a special reserve, would be subject to proper statutory safeguards and governed by the continuation or resumption of excessively rapid bank credit expansion. If present inflationary pressures should relax, the authority need not be applied, or if already applied, its requirements could be eased or withdrawn if necessary to discourage liquidation of bank credit.

Potential expansion of bank credit on the basis of any increase in reserves could be reduced by higher levels of reserve requirements. In addition, provision of authority to establish such levels would enable the Federal Reserve System to use its customary instruments of open market operations and discount rates with greater effectiveness and flexibility than postwar conditions have heretofore permitted.

Another measure to help curb prevailing inflationary credit tendencies, recommended by the Board to the 80th Congress, is the re-establishment of control over the terms of consumer instalment credit. Regulation of consumer credit by the Federal Reserve System, which had been in effect under Executive Order since September 1, 1941, was terminated on November 1, 1947, by congressional action. Temporary restoration of the Board's authority, so far as it related to consumer instalment credit, was subsequently approved by the Senate—in December, by S. J. Res. 157; the House of Representatives referred the resolution to its Committee on Banking and Currency, which has taken no action on the matter.

The Board favors this legislation as a timely anti-inflationary measure. The Board continues to recommend, as an anticyclical measure, the enactment of permanent legislation authorizing the regulation of consumer instalment credit. For the reasons set forth in the Board's *Annual Reports* for 1945 and 1946, permanent authority would assist in "the over-all program of stabilizing the national economy at a high level of production and employment."

Re-establishment of this control at the present time would help to dampen consumer demand, especially for durable goods, financed on time-payment plans. This would help to restrain further inflationary growth in consumer expenditures and reduce upward pressures on consumer and other prices. Consumer instalment credit regulation would also discourage many American families from going too heavily into debt on easy terms for goods, in many cases of inferior quality, selling at inflated prices. In this way, it would assist in deferring consumer buying until such time as inflationary tendencies have abated and an increase of consumer expenditures would be desirable in the interest of general economic stability. It would also diminish the deflationary effects of debt liquidation in a period of declining incomes.

The Board fully recognizes that the current inflationary problem has its genesis largely in the monetary upheaval due to war expenditures and also that many of the basic and continuing causes of present inflationary developments lie outside the field of monetary and banking matters. The Board, nevertheless, believes that the Federal Reserve System should be prepared to take such action in the monetary field as seems necessary to help accomplish the purpose for which the System was established, namely, to provide the basis for a supply of money and credit regulated to the best interests of the economy.

LEGISLATIVE PROPOSALS

As stated in the previous section, the Board recommended to Congress in 1947 specific legislation to authorize the establishment of a temporary special reserve requirement on commercial banks and also to restore authority to regulate consumer instalment credit. These proposals were especially designed to deal with current inflationary developments in the economy. Other legislative proposals made by the Board were the following.

Bank holding company legislation. The Board has repeatedly pointed out the inadequacy of the existing law relating to bank holding companies and the need for new legislation to provide more effective supervision and control of such companies. The Board has recommended legislation which would treat bank holding companies in much the same manner as banks themselves and include provisions regulating expansion and requiring the divorcement of all activities unrelated to banking. During 1947, hearings were held by the Senate and House Committees on Banking and Currency, and the Senate Committee reported favorably a bill, S. 829, designed to carry out the Board's recommendations. The Board believes that this legislation is urgently needed and that action with respect to it should not be delayed.

Reserve Bank guarantee of loans to business. The Board again recommends the enactment of legislation, discussed in its *Annual Report* for 1946, which would give the Federal Reserve Banks more effective authority to guarantee in part business loans made through established banking channels. This proposal is designed primarily to strengthen and make more effective the existing facilities for financing smaller business enterprises. It is intended particularly to assure the availability of long-term loans to supply necessary capital which such businesses could not otherwise obtain.

Section 13b of the Federal Reserve Act now authorizes the Federal Reserve

Banks to make and to guarantee industrial loans, but it contains provisions which are so restrictive as to impair seriously the ability of the Reserve Banks to assist in business financing. Under the Board's proposal, Section 13b would be repealed and the authority to make loans directly to business enterprises would be eliminated. In lieu of Section 13b, a new statutory provision would be enacted which would give the Reserve Banks more adequate authority to guarantee loans than they now possess. The maximum maturity of a guaranteed loan would be 10 years, and the maximum proportion of a loan which could be guaranteed would be 90 per cent. With the repeal of Section 13b, the Reserve Banks would be required to return funds heretofore advanced to them by the Treasury for use in their industrial loan activities. The appropriation of about 139 million dollars available under existing law for industrial loan operations of the Reserve Banks would be repealed and Government funds no longer would be used for this purpose.

Hearings on the Board's proposal were held by the Senate and House Committees on Banking and Currency during 1947 and the Senate bill, S. 408, was reported favorably by the Senate Committee. While the proposed authority would not be used extensively under existing conditions, the Board believes that this legislation should be enacted to provide stand-by authority for use as the need arises.

Capital requirements for member banks. As stated in its *Annual Report* for 1946, the Board believes that the law governing the establishment of branches by national and State member banks should be amended to eliminate requirements, particularly with respect to capital, which result in unwarranted discrimination against these classes of banks. It also believes that consideration should be given to the modification of the capital requirements for the admission of State banks to membership in the Federal Reserve System.

GOVERNMENT FINANCE

Development of a budget surplus in 1947, for the first calendar year since 1930, was an anti-inflationary influence. This surplus amounted to only 1.8 billion dollars but, as is indicated in the accompanying table, it compared with a deficit of 3.5 billion in 1946 and one of 43.7 billion in 1945. By using this surplus and drawing down the balance in its general fund, the Treasury reduced the public debt by 2.2 billion dollars to 257 billion. Moreover, as previously pointed out, by using cash received from the sale of nonmarketable securities, the marketable public debt was reduced from 177 billion dollars to 166 billion, and a large part of this decline was in the holdings of the banking system.

BUDGET EXPENDITURES AND RECEIPTS AND CHANGES IN PUBLIC DEBT
[In billions of dollars]

	Calendar year		
	1947	1946	1945
Expenditures[1]	42.1	45.1	89.8
Net receipts	44.0	41.6	46.0
Budget surplus (+) or deficit (−)[1]	+1.8	−3.5	−43.7
Change in:			
General fund balance	−0.4	−22.5	+3.8
Gross public debt	−2.2	−19.0	+47.5
Marketable public debt	−10.9	−22.2	+37.1

[1] Including net transactions of trust accounts, etc., and clearing account items, which are not ordinarily reflected in the budget surplus or deficit.

Total marketable debt that matured or was called during the year amounted to 38 billion dollars, excluding weekly maturities of Treasury bills. Of this total, 30 billion consisted of certificates, 6.3 billion of notes, and 1.5 billion of bonds. About 9 billion of these redemptions were paid off in cash and the remainder were refunded into certificates and short-term notes. In addition, Treasury bills in the amount of nearly 2 billion dollars were paid in cash. Major changes in the composition of the marketable and nonmarketable debt are shown in the following table.

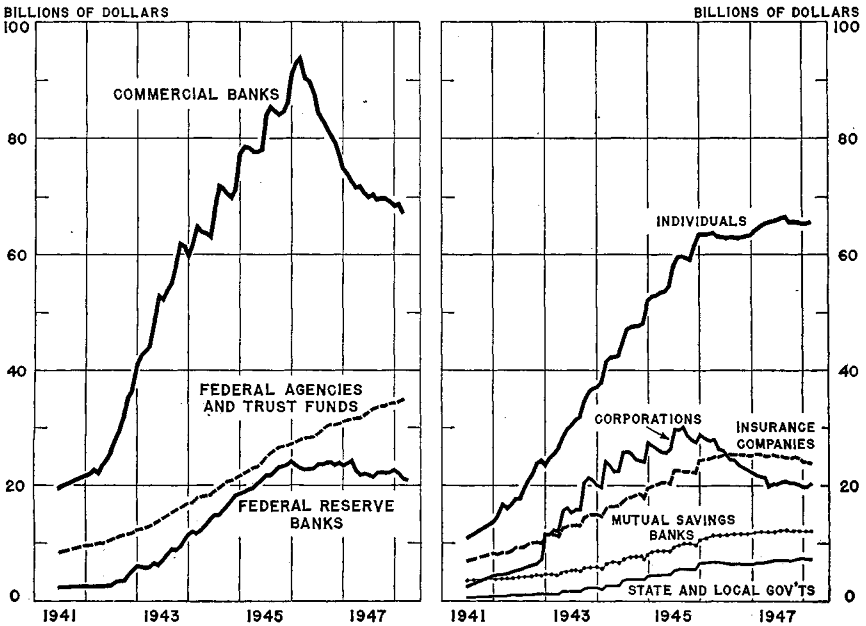
PUBLIC DEBT OUTSTANDING, BY TYPE OF ISSUE[1]
[Par value, in billions of dollars]

Type of issue	1947	1946	1945
Interest-bearing debt: total	**254.2**	**257.6**	**275.7**
Marketable issues: total	*165.8*	*176.6*	*198.8*
Treasury bills	15.1	17.0	17.0
Certificates	21.2	30.0	38.2
Treasury notes	11.4	10.1	23.0
Treasury bonds, due or callable:			
Within 1 year	6.4	1.5	2.3
1–5 years	46.4	35.8	25.3
After 5 years	65.0	82.0	92.8
Other	0.2	0.2	0.2
Nonmarketable issues: total[2]	*59.5*	*56.5*	*56.9*
Savings bonds	52.1	49.8	48.2
Savings notes	5.4	5.7	8.2
Armed forces leave bonds	0.8	0.6	....
Investment bonds	1.0	....	....
Depositary bonds	0.3	0.3	0.5
Special issues	*29.0*	*24.6*	*20.0*
Matured debt and debt bearing no interest	**2.7**	**1.5**	**2.4**
Gross public debt	**256.9**	**259.1**	**278.1**

[1] Excludes guaranteed securities, which are included in the table on p. 15.
[2] Excludes special issues, which are shown separately below.
NOTE: Figures are for Dec. 31; details may not add to totals because of rounding.

Changes in ownership of the public debt resulted primarily from the debt-retirement program but also to an important extent from purchases and sales in the market. The largest decline—nearly 6 billion dollars—was in holdings of commercial banks; about two-thirds of this reduction reflected retirement of matured issues and the remainder sales to maintain reserve positions in view of Treasury withdrawals of funds and expanding demand for loans. The net decline in Federal Reserve holdings of less than a billion dollars reflected retirements of about 3 billion offset by purchases in the market. Individuals added to their holdings of savings bonds. State and local governments further increased their holdings of marketable securities, while corporations continued to reduce theirs. These and other changes are reflected in the accompanying chart.

OWNERSHIP OF U. S. GOVERNMENT SECURITIES



NOTE: Chart relates to interest-bearing debt, direct and guaranteed. Reported holdings are shown for (1) Federal agencies and trust funds and (2) Federal Reserve Banks, and Treasury estimates for other groups. Figures are for June and December 1941 and for end of each month thereafter.

Every class of investor, but particularly insurance companies, commercial banks, and mutual savings banks, offered bank-eligible bonds for sale in the market. Net offerings were absorbed by the Federal Reserve in support of the market. Restricted bonds were sold from United States agency accounts during the summer in order to restrain declines in long-term interest rates. They were originally taken up by institutional investors, but subsequently these investors sold restricted issues, which were purchased by the Treasury and the Federal Reserve. Mutual savings banks purchased enough restricted bonds to cancel their sales of bank-eligible bonds. Commercial banks and to a small extent insurance companies, in addition to selling bonds, sold certificates and notes principally to the Federal Reserve. On the other hand, commercial banks, and to a lesser extent corporations, acquired Treasury bills from the Federal Reserve. Net changes in holdings of the various classes of issues by the major groups of holders are shown in the table.

Changes in Ownership of United States Government Securities during 1947

[Partly estimated; par value, in billions of dollars]

Type of issue	Total outstanding	U.S. Gov't agencies and trust funds	Federal Reserve Banks	Commercial banks	Mutual savings banks	Insurance companies	Indiv's, corp's, municip's, and others
Marketable issues: total	**−10.9**	**−1.0**	**−0.8**	**−5.8**	(1)	**−1.4**	**−1.9**
Treasury bills	−1.9	(1)	−3.3	+0.9	(1)	+0.1	+0.4
Certificates	−8.8	(1)	−0.7	−5.1	−0.1	−0.2	−2.7
Treasury notes	+1.3	(1)	+1.1	−0.8	−0.1	−0.4	+1.5
Treasury bonds: total	*−1.5*	*−1.0*	*+2.1*	*−0.8*	*+0.2*	*−1.0*	*−1.0*
Due or callable:							
Within 1 year	+5.0	(1)	+0.2	+3.7	+0.2	+0.1	+0.8
1–5 years	+10.6	−0.2	+0.8	+6.7	+0.8	+1.0	+1.5
5–10 years	−17.0	−0.2	+0.4	−11.2	−1.5	−2.0	−2.6
After 10 years:							
Bank eligible	....	+0.1	+0.1	+0.1	(1)	−0.2	−0.1
Restricted	....	−0.8	+0.6	−0.1	+0.6	+0.2	−0.5
Other	(1)	(1)	....	(1)	(1)	(1)	(1)
Nonmarketable issues: total[2]	**+2.8**	**+0.1**	....	**−0.1**	**+0.2**	**+0.4**	**+2.3**
Special issues	**+4.4**	**+4.4**	....	....	....	....	....
Total, interest-bearing securities[3]	**−3.7**	**+3.4**	**−0.8**	**−5.9**	**+0.2**	**−1.0**	**+0.4**

[1] Less than .05 billion dollars.
[2] Excludes special issues, which are shown separately below.
[3] Includes guaranteed securities, which are excluded in the table on p. 13.
Note: Detailed figures may not add to totals because of roundings.

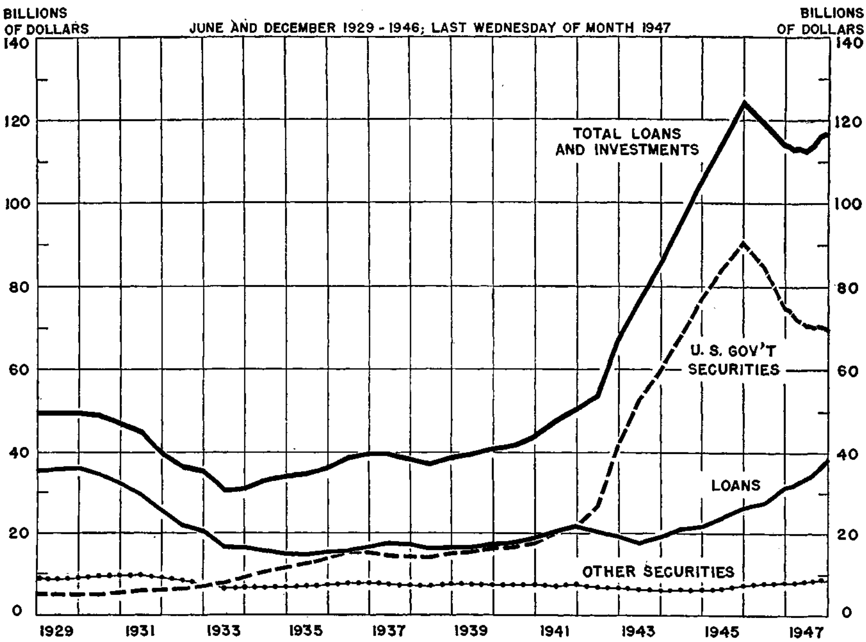
Treasury transactions through the surplus and through sales of nonmarketable securities, as has been explained in other sections of this report, had the effect of drawing funds from bank deposits and bank reserves, while retirement of securities returned a portion of the funds. Factors that expanded deposits and reserves, however, more than offset the drain from Treasury operations.

BANK CREDIT DEVELOPMENTS

Strong demand for bank credit by most of the major users other than the United States Government—businesses, consumers, real estate owners, and State and local governments—was the most striking characteristic of the banking situation in 1947. Bank loans increased by about 7 billion dollars, the largest annual increase in the history of American banking. This loan growth, which followed a sharp revival of bank lending activities in 1945 and 1946, raised the year-end volume of outstanding loans at commercial banks above 38 billion dollars, some 2 billion higher than the previous peak in 1929.

This growth in loans, together with an increase of about a billion dollars in holdings of other securities, as is shown in the chart, exceeded the further decrease in commercial bank portfolios of United States Government securities. As a consequence, there was a growth in total loans and investments, following a decline in 1946. Bank reserves also increased, as a result of an inflow of gold, which was only partly offset by other factors affecting reserves. Total deposits at commercial banks showed a renewed growth, following the reduction due to the large withdrawals from war loan accounts in 1946.

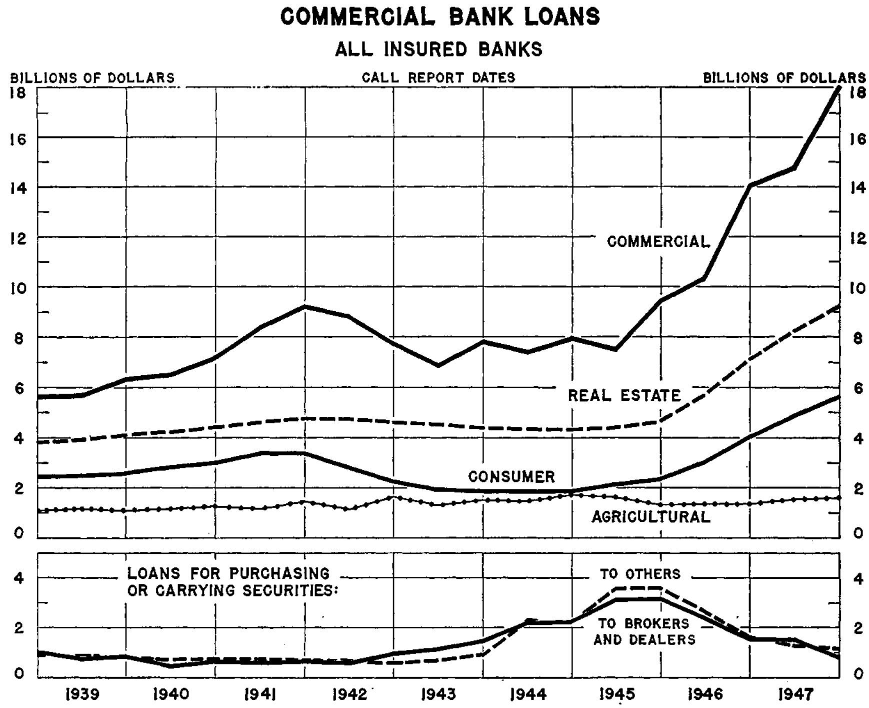
LOANS AND INVESTMENTS OF ALL COMMERCIAL BANKS



NOTE: Figures are for all commercial banks in the United States. U. S. Government securities and other securities are for June dates only through 1935. Monthly figures are partly estimated.

Nature of loan expansion. Use of bank credit by business continued to grow in 1947, as is shown in the chart on the following page. During the year commercial and industrial loans at all insured commercial banks increased by close to 4 billion dollars, nearly the same growth as occurred in 1946. At the end of the year bank loans to business were over 18 billion dollars, more than twice the amount outstanding at the cessation of hostilities in mid-1945.

Vigorous business demand for bank credit reflected sharply increased needs for working capital at current levels of costs, prices, and sales, as well as an extraordinarily large current volume of expenditures for plant and equipment. Many companies, particularly those engaged in processing foods and other



NOTE: All insured commercial banks in the United States. Commercial loans include commercial and industrial loans, open market commercial paper, and acceptances. Consumer loans are partly estimated prior to Dec. 31, 1942.

agricultural commodities, used bank credit because of higher raw material prices and actual and anticipated advances in other business costs such as wages and transportation expenses. Some concerns borrowed to finance a growing volume of business. A part of the expenditures of big utility companies, oil companies, and manufacturers of machinery were financed out of bank loans. Many of these loans were arranged on a term basis, while many were short-term advances. In numerous instances, bank loans were used as an interim source of funds in anticipation of retained profits or until new security issues were floated. Their effect, however, was to expand the volume of bank credit. Borrowings of instalment finance companies at banks, which are included in business loans, reflect a part of the growth in consumer credit.

Farmers as a group have shown little increase in their borrowing at banks since the end of the war. Much of the growth that has occurred is attributable to credit grants for purchase of farm machinery and equipment and for other capital improvements. Loans on farm real estate by banks have increased only moderately.

Active residential and nonresidential construction, the extensive relocation of families in recent years, and rising real estate values resulted in further extension of bank credit to owners of urban real estate. Urban mortgage loans of insured commercial banks increased 2 billion dollars over the year and at the end of 1947 amounted to 8.5 billion, or almost one-fourth of the banks' total loan portfolios. A substantially larger portion of new urban mortgage business was handled by banks in 1947 than in prewar years.

Consumers had recourse to bank credit in increasing volume in 1947 to finance purchases of durable goods, expenditures for current living, and outlays for other purchases. Bank loans to consumers increased 1.6 billion dollars, largely in instalment loans for repair and modernization of houses and for purchases of automobiles and other consumer durable goods.

The increase in total consumer credit, including that extended by dealers and by nonbank lenders as well as by banks, approximated 3.2 billion dollars. This was about one-third of a billion less than the increase during 1946, and most of the difference was due to a smaller increase in charge accounts. For consumer instalment credit, on the other hand, the increase of more than 2 billion dollars was one-third again as large as the growth in 1946. The large increase in consumer instalment credit reflected the influence of such factors as growing supplies of consumer durable goods, a substantial increase in loans for the repair and modernization of residental property, further resort to borrowing by consumers pressed by the rising cost of living, and active promotional work by credit grantors. Consumer instalment credit was under restraint imposed by the Board's Regulation W until November 1, when this regulation was terminated by congressional action.

Bank loans for purchasing and carrying securities declined by a further billion dollars in 1947. This decline reflected continued liquidation of the substantial volume of bank credit extended in connection with purchase of Government securities in the Victory Loan Drive at the end of 1945. Loans for purchasing or carrying securities other than United States Government securities changed little throughout the year and maintained an average level slightly below that for 1946. There was a small increase, amounting to less than 50 million dollars, in credit extended for this purpose by brokers to their customers, but these credits continued generally at around the lowest levels of the past three decades.

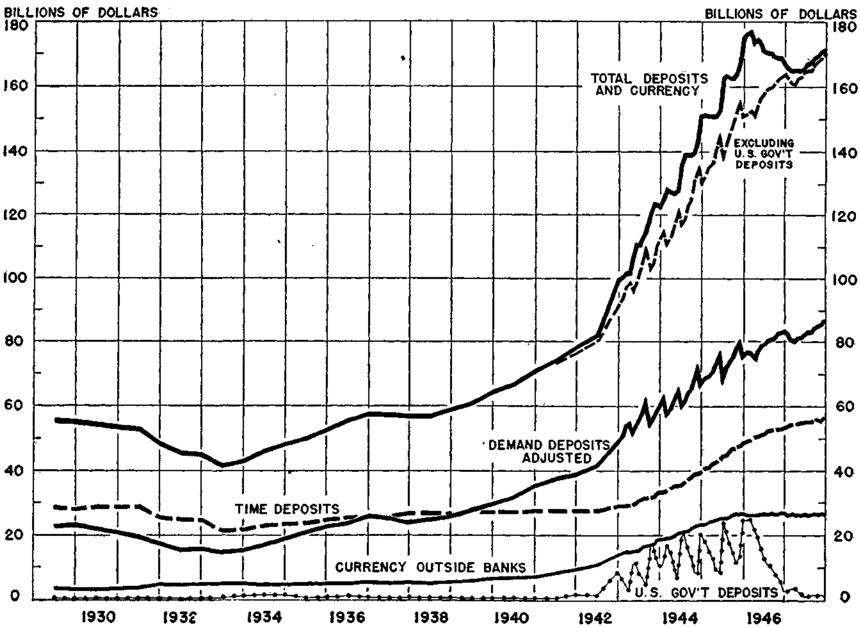
The relative stability in credit to purchase or carry securities accompanied little change in the level of stock prices and the volume of trading on the New York Stock Exchange. A factor in the continued small volume of stock market credit, in contrast to expansion of such credit in most other periods of inflationary developments, was the maintenance of margin requirements at a high level by the Board's Regulations T and U. These requirements, which were raised to the 100 per cent level during 1946, were reduced to 75 per cent effective February 1, 1947.

Bank holdings of municipal and corporate securities. State and local governments floated an exceptionally large volume of new securities in 1947, and bank portfolios of such securities increased by 900 million dollars. This growth compares with issues for new money of about 2 billion dollars and an increase in the total volume of securities outstanding of somewhat more than a billion. At the end of the year commercial banks held about 5.3 billion of State and local government securities, the largest amount ever held. Several large veterans' bonus issues by States were in part taken by city banks. Country banks expanded their portfolios, largely by subscription to numerous local security offerings of municipalities and other political subdivisions to finance construction projects. Corporate sales of new-money bond issues were large in 1947 but bank holdings of corporate securities did not increase.

Growth of deposits. Monetary expansion continued in 1947, and total deposits and currency held by individuals and businesses increased by more than 6 billion dollars. As is shown in the chart, growth was particularly rapid in the last quarter when deposits expanded at a rate of about one billion dollars a month. At the end of 1947, privately held deposits and currency totaled 170 billion dollars, 24 billion more than when hostilities ceased in August 1945 and 107 billion above the level of 1939.

Demand deposits of individuals and businesses increased by a net amount

BANK DEPOSITS AND CURRENCY



NOTE: Figures are partly estimated. Deposits are for all banks in the United States. Demand deposits adjusted exclude U. S. Government and interbank deposits and items in process of collection. Time deposits include deposits in the Postal Savings System and in mutual savings banks. Figures are for June and December, 1929–42; end of month, 1943–46; last Wednesday of month, 1947.

of almost 4 billion dollars. In the first quarter of the year these deposits were drawn down to meet heavy income-tax payments, but in the succeeding three quarters they grew by 6.8 billion dollars. Their total at the end of the year was 87 billion, the largest amount on record.

Time deposits at commercial and mutual savings banks increased by about 2.5 billion dollars during the year. The increase, although less than in the war and early postwar periods, was larger than in most previous peacetime years. The slackening rate of growth reflected a substantial reduction in current personal savings from abnormally high wartime levels.

Deposit expansion was general throughout the country and occurred at most banks in both large and small centers. Growth was particularly rapid, however, in the middle western and southwestern areas, where it probably reflected in large part the rapid rise in prices of grains and meats. The smallest change was in the northeastern part of the country.

Expansion of bank loans was the major factor in the growth of deposits in 1947, as is shown in the accompanying table. A gold inflow of over 3 billion dollars and increased bank holdings of State and local government securities also expanded deposits. A reduction of 1.2 billion dollars in United States Government deposits was an additional factor in private deposit growth.

Treasury fiscal and debt-retirement operations, on the other hand, tended to reduce deposit expansion in 1947. The Treasury excess of current cash receipts, resulting from the budget surplus and sales of nonmarketable

FACTORS IN EXPANSION OF DEPOSIT AND CURRENCY HOLDINGS OF INDIVIDUALS AND BUSINESSES

Changes in Amounts Outstanding during 1947

[In billions of dollars, partly estimated]

Factors in deposit change	Total	Fourth quarter	Third quarter	Second quarter	First quarter
Expansive factors					
Bank loans	+7.3	+2.6	+2.0	+1.4	+1.2
Bank holdings of municipal and corporate securities	+1.2	+0.2	+0.5	+0.3	+0.3
Holdings of U. S. Government securities:					
Commercial and mutual savings banks	....	....	+0.3	....	....
Federal Reserve Banks	....	+0.4	+0.2	....	....
Gold certificates	+3.1	+0.8	+0.7	+0.9	+0.8
U. S. Government deposits	−1.2	−0.3	....	−3.2	....
Other factors, net	....	−0.9	....	....	....
Contractive factors					
Holdings of U. S. Government securities:					
Commercial and mutual savings banks	−5.3	−1.7	....	−1.7	−2.2
Federal Reserve Banks	−0.8	....	....	−0.9	−0.5
U. S. Government deposits	....	....	+0.5	....	+1.8
Other factors, net	+0.5	....	+0.6	+0.4	+0.5
Change in deposits and currency held by individuals and businesses: total	**+6.2**	**+3.5**	**+2.6**	**+2.8**	**−2.7**
Demand deposits, adjusted	+3.9	+3.0	+2.1	+1.7	−2.9
Time deposits	+2.5	+0.4	+0.4	+0.9	+0.8
Currency outside banks	−0.2	+0.1	+0.1	+0.2	−0.6

NOTE: Figures cover all commercial banks, Federal Reserve Banks, mutual savings banks, and the Postal Savings System; interbank items are excluded. Changes for 1947 are based on figures for the last Wednesday in the first and third quarter and for the June 30 and December 31 call report dates in the second and fourth quarters respectively. Details may not add to totals because of rounding.

securities, in the first instance drew upon private deposits. Use of some surplus funds by the Treasury for retirement of securities held by nonbank investors returned funds to private balances. Since most of the Treasury cash surplus was used to retire bank-held debt, however, the deposits drawn down were to a large extent extinguished. It is estimated that the net result of Treasury operations on private bank deposits was a drain of more than 6 billion dollars.

Availability of bank reserves. Extension by banks of substantial amounts of credit to individuals, businesses, and State and local governments was made possible in 1947 by an increase in member bank reserves. As is shown in the accompanying table, the banking system acquired about 3 billion dollars of reserves during the year as a consequence of the gold inflow resulting from the large surplus of exports over imports. This increase in bank reserves was offset in part by a shift of funds out of commercial banks by the Treasury and the use of these funds to retire securities held by the Federal Reserve Banks and to increase Treasury balances with the Reserve Banks. The net result was an increase of 700 million dollars in member bank reserve balances.

Vigorous demand for bank credit and the desire of bankers to maintain or increase earnings in the face of rising operating costs resulted in substantial bank sales of short-term Government securities to obtain funds to acquire more profitable assets. These securities were largely purchased by the Federal Reserve, and the resulting additions to bank reserves in part offset the effect of the use of excess Treasury receipts to retire securities held by the Reserve Banks.

In the period March through June, substantial reduction of Federal Reserve

SUPPLY AND USE OF MEMBER BANK RESERVE FUNDS

[In millions of dollars]

Item	Year ending[1]	
	December 1947	December 1946
Changes increasing reserves:		
Gold stock	[2]+2,224	+441
Treasury cash	[2]−926	−13
Treasury currency	+4	+230
Currency in circulation	−60	
Reserve Bank credit		+2
Nonmember deposits at Federal Reserve Banks		−395
Treasury deposits at Federal Reserve Banks		−69
Changes decreasing reserves:		
Reserve Bank credit	−1,888	
Nonmember deposits at Federal Reserve Banks	+164	
Treasury deposits at Federal Reserve Banks	+411	
Currency in circulation		+545
Other	+8	+113
Member bank reserve balances: total	+744	+490
Required	+657	+1,088
Excess	+87	−598

[1] Changes based on monthly averages of daily figures for December 1945, 1946, and 1947.
[2] The increase in gold stock was substantially smaller than net gold acquisitions from foreign countries because 700 million dollars in gold was contributed by the United States to the International Monetary Fund during the year.

holdings of Government securities by Treasury retirement of marketable securities tended to neutralize the effect of the gold inflow on reserves. Subsequent gold movements were not offset in this way, however, and went to increase member bank reserves and to finance the seasonal increase in currency in circulation late in the year. Since additions to reserves available from the gold inflow were not adequate to meet both the increase in currency circulation and the rapid expansion of bank credit, banks sold some securities to bolster reserve positions in the last quarter. They also benefited in this period by an increase in reserves resulting from Federal Reserve absorption of sales of Government securities by nonbank investors.

Treasury operations were almost as restrictive in their effect on bank reserves in 1947 as in 1946, although total operations were much smaller. In 1946 debt retirement was effected by calls on war loan balances at the banks, which had been built up largely during the Victory Loan Drive. These calls in the first instance acted to drain bank deposits and reserves by 29 billion dollars, but 25 billion was returned to bank reserves by the retirement of securities and other Treasury disbursements. The process was largely one of drawing on Treasury deposits at banks to retire Government securities held by banks. It had little net effect on the reserve positions of banks, and it did not affect private deposits and the amount of required reserves, especially since Treasury war loan deposits were at that time not subject to reserve requirements.

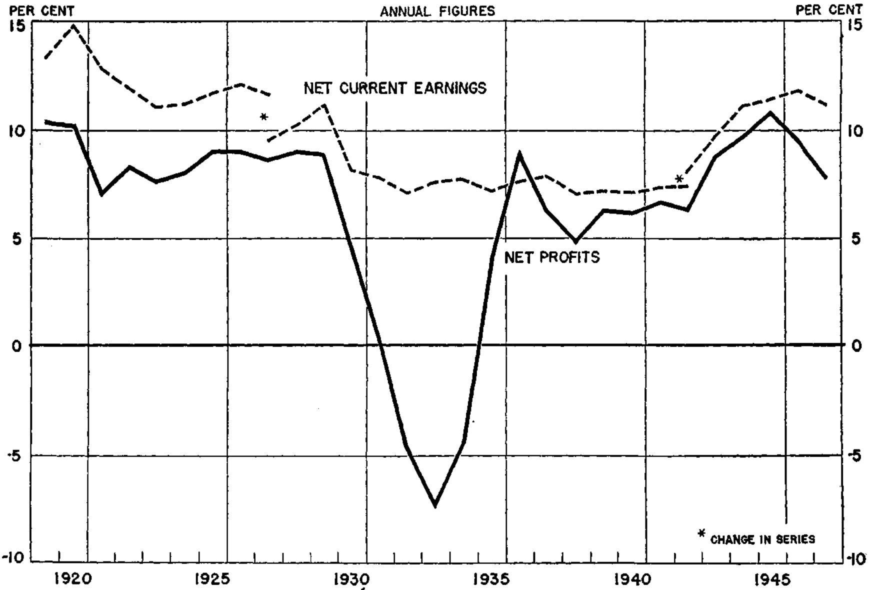
Cash retirement of securities held by the Reserve System amounted to almost 4.6 billion dollars in 1946. Such retirement in 1947 was little more than 3 billion dollars; in addition there was some increase in Treasury balances at the Reserve Banks, making a total drain on bank reserves through Treasury fiscal and debt retirement operations of 3.5 billion for the year.

Bank earnings and earning assets. Member bank net profits after taxes were 653 million dollars in 1947, 105 million lower than in the preceding year and 135 million lower than in the peak year 1945. Net current operating earnings before income taxes were only slightly smaller in 1947 than in 1946 since increased earnings on loans and other earning assets almost entirely offset the decline in earnings on United States Government obligations and increases in all major items of expense. About 43 per cent of net profits was distributed as dividends and the remainder was added to capital accounts.

Net profits of member banks were 7.9 per cent of total capital accounts in 1947 as compared with 9.6 per cent in 1946, thus continuing the downward trend of this ratio from the peak of nearly 11 per cent reached in 1945. The declines were due in part to increases in capital accounts. As is shown in the accompanying chart, the present ratio of net profits to total capital accounts approximates the level of the late 1920's but is higher than the level of the late 1930's and early 1940's. The upward trend of the ratio of net current earnings before income taxes to total capital accounts was reversed in 1947 when the ratio declined to 11.2 per cent from a high of nearly 12 per cent in 1946.

EARNINGS RATIOS OF MEMBER BANKS

PERCENTAGES OF CAPITAL ACCOUNTS



NOTE: Net current earnings are total earnings from current operations less current operating expenses. Net profits are net current earnings plus recoveries, profits on securities, etc., less losses and charge-offs and taxes on net income. Capital accounts consist of all forms of capital, including capital notes and debentures, surplus, undivided profits, reserves for contingencies, and other miscellaneous capital accounts. Prior to 1927 profits on securities were included in current earnings; beginning in 1942 taxes on net income were excluded, while recurring depreciation was included, as a current operating expense deduction from earnings.

Earning assets of member banks amounted to 98 billion dollars at the close of 1947, an increase of about 1.5 billion during the year. A decline of more than 5 billion dollars in holdings of United States Government obligations during the year was more than offset by an increase of about 7 billion dollars in loans and other securities. Corresponding changes during 1946 had been a decrease of over 15 billion dollars in holdings of United States Government securities and an increase of about 4 billion in holdings of loans and other securities. Low-yield loans for the purpose of purchasing or carrying securities declined further during 1947, both actually and relatively to total loans. Other major classes of loans with higher yields increased, for the most part during the second half of the year. There was a further increase during the year in member bank holdings of State and local government securities. Changes in earning assets during the year are shown in the table on page 24.

Reflecting debt retirement, shifts in bank portfolios, and increases in yields on short-term Government securities since the middle of 1947, the average yield to member banks from their Government security holdings increased from 1.48 per cent in 1946 to 1.53 in 1947. The average yield on loans also increased, rising from 3.18 per cent to 3.54. This was partly because member banks, particularly reserve city and country banks, tended to hold larger proportions of their loans in the form of higher-yield real estate and consumer loans.

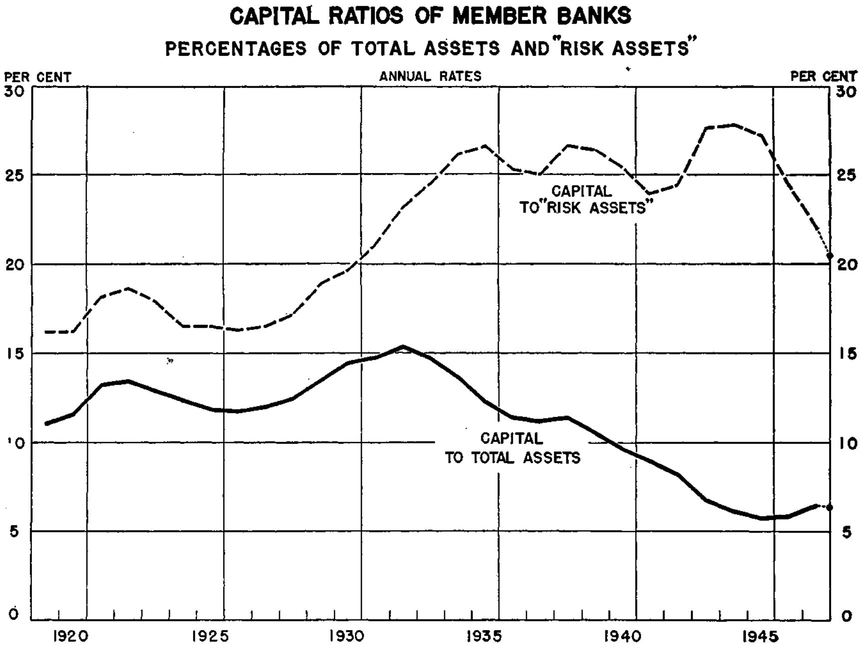
MEMBER BANK LOANS AND INVESTMENTS
[In billions of dollars]

	Outstanding Dec. 31, 1947	Change during year	
		1947	1946
Loans and investments: total	**97.8**	**+1.5**	**−10.8**
Loans: total	**32.6**	**+5.9**	**+3.9**
Commercial and industrial loans	17.0	+3.8	+4.2
Agricultural loans	1.0	+0.2	....
Loans for purchasing or carrying securities	1.9	−1.1	−3.5
Real estate loans	7.1	+1.8	+1.9
Consumer loans	4.7	+1.4	+1.4
All other, including loans to banks	1.0	−0.1	−0.1
U. S. Government securities, direct and guaranteed: total	**57.9**	**−5.1**	**−15.3**
Bills, certificates, and notes	12.6	−4.2	−16.7
Bonds	45.3	−0.9	+1.4
State and local government securities	**4.2**	**+0.7**	**+0.3**
Other securities	**3.1**	....	**+0.3**

Capital accounts. Capital accounts of member banks increased by 369 million dollars in 1947, after having increased by 506 million in 1946 and 621 million in 1945. Retention of profits accounted for the current increase; aggregate sales of additional stock were about the same as retirements of preferred stocks and capital notes held by the Reconstruction Finance Corporation. Dividend payments amounted to 280 million dollars in 1947.

The ratio of average total capital accounts to average total assets increased to 6.5 per cent during 1947, capital accounts having increased relatively more than total assets. As is shown in the accompanying chart, this was the second successive year of increase in this ratio.

In contrast, the ratio of average total capital accounts to average risk assets, defined to include all assets other than cash and United States Government securities, fell from almost 25 per cent in 1946 to 22 per cent in 1947, the lowest ratio since 1931. The decline from the preceding year resulted from a far greater relative growth in so-called risk assets than in total capital accounts. As has been noted previously, there was an over-all growth of 7 billion dollars in risk assets, including a shift of 5 billion dollars from Government securities.



NOTE: "Risk assets" represent total assets other than cash assets and U. S. Government securities. Capital and asset figures are based on averages of June and December call date figures 1919–40 and of three or four call date figures thereafter.
● Indicates Dec. 31, 1947, call date ratio.

BOND MARKET AND MONEY RATES

The cost of money increased further in 1947, with all of the increase in the second half of the year. At the end of the year long-term rates were close to those prevailing immediately before the war while most short-term rates were near those of the early thirties. Such rates, however, were substantially lower than those of the twenties. Accompanying the increased cost of money, new securities of private corporations and of State and local governments were issued in large volume and bank loans increased substantially.

Short-term money rates on United States Government obligations began to rise in July when the Federal Reserve System discontinued the fixed buying rate and repurchase option for Treasury bills issued on or after July 10, 1947. Thereafter rates on Treasury bills, which had been held at 3/8 per cent since 1942, increased sharply, and at the end of the year new issues were yielding almost one per cent. The Treasury also took action to increase yields on Treasury certificates. On August 1 an 11-month 7/8 per cent certificate was offered in exchange for a maturing 12-month certificate bearing the same rate. Later a certificate bearing the rate of 1 per cent was issued and in December a 13-month 1 1/8 per cent note was offered in exchange for a 12-month 7/8 per cent certificate maturing on December 1, as well as for a bond issue maturing

December 15. This was followed on January 1, 1948 by an exchange offering of a 12-month 1⅛ per cent certificate. Average yields on 9 to 12-month certificates increased from 0.85 per cent in July to 1.09 per cent in January 1948.

Private short-term money rates also firmed somewhat during the last half of 1947. Open market rates on bankers' acceptances, loans to brokers and dealers secured by Government obligations, and commercial paper rose. Some banks also announced increases in the rates charged their commercial and industrial borrowers although the average of such rates continued at a low level.

The increase in short-term money rates reflected the pressure of a growing demand for bank credit, which in the third quarter became very large and affected long-term rates. Monetary action to permit some change in short-term rates introduced a degree of flexibility in the money market.

Long-term interest rates on both public and private obligations remained relatively stable prior to September, but in this period excess funds in the market were partly absorbed by substantial sales of marketable Government bonds by Federal agencies and trust funds. Financial institutions, however, largely replenished funds invested in these bonds before the end of September by the sale of other securities to banks.

Beginning in September there was a decline in bond prices, with a rise in yields, which was due to many factors that had been accumulating pressure during the two preceding years. Large institutional investors, particularly insurance companies, were confronted with a rapidly increasing demand for funds by home owners, businesses, and State and local governments. In addition, the Treasury offered a new 2½ per cent long-term nonmarketable bond to savings institutions. Finally, the market was affected by the intensified efforts of monetary authorities to put pressure on bank reserves and restrain credit, and the possibility of future changes in credit policy and interest rates.

The rise in long-term interest rates (decline in bond prices), which started in the corporate bond market early in September, proceeded almost uninterruptedly until the middle of October. During these six weeks the yield on high-grade corporate issues increased from 2.52 to 2.70 per cent. The yield on long-term Government bonds remained fairly steady during this period, with the result that the spread between the yields of corporate and Government bonds increased somewhat.

In the middle of October the weakness in the corporate bond market spread to Government securities and the yields on taxable Government bonds with a maturity of 15 years or more rose from 2.26 in mid-October to 2.37 per cent in mid-November. At that point the increase was stopped by open market support purchases of these securities by the Federal Reserve System and the Treasury.

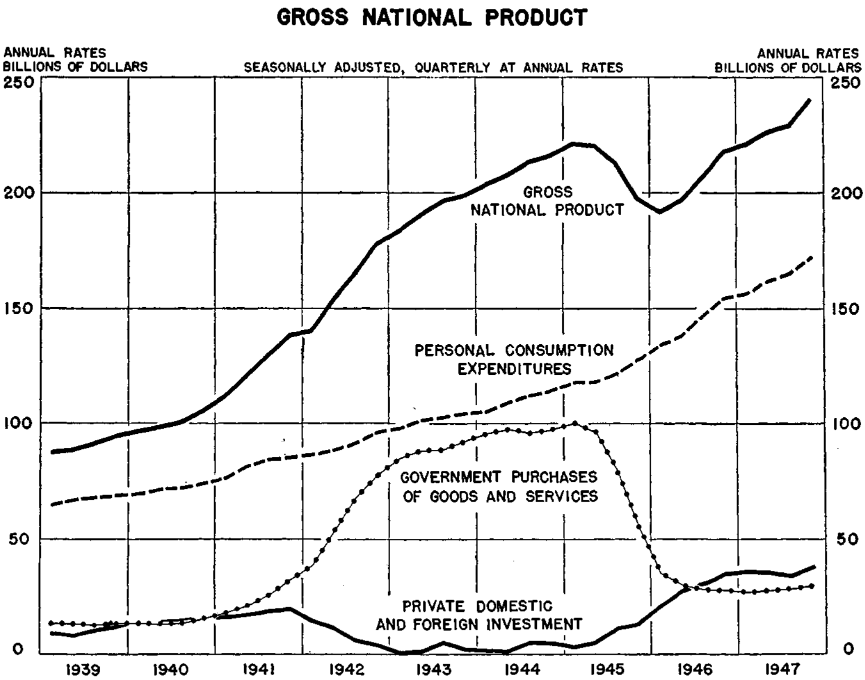
From mid-November to late December there was practically no change in yields on long-term Government securities and yields on private long-term obligations fluctuated within a fairly narrow range. On December 24 a new lower support level for Government bonds was established by the Open Market Committee of the Federal Reserve, and yields on Government bonds rose generally to that support level; yields on other types of long-term securities also rose further. The yield on high-grade corporate bonds had risen to 2.91 per cent by the end of the year, that on municipal bonds to 2.46 per cent, and that on long-term Governments to 2.45 per cent.

At the end of the year the spread between the yields of high-grade corporate and United States Government bonds was greater than at any time since fully taxable long-term Government bonds were issued (1941), and the yield on high-grade municipal bonds was higher than the yield on long-term taxable Governments for the first time since early 1942. These changes in the relative costs of different types of long-term money reflected primarily a changing pattern of demand for funds. During the war, corporate and municipal demand for new money was small and Federal Government demand large; during 1946 and 1947, corporate and municipal demand rose considerably while the Federal Government actually reduced the volume of its marketable debt outstanding.

The cost of equity funds to corporations also rose somewhat in 1947. Preferred stock yields (dividend-price ratios) fluctuated little during the first three quarters of the year but rose from 3¾ to 4 per cent during the last quarter. This upward movement reflected primarily the increase in long-term interest rates. Common stock yields, as represented by a dividend-price ratio for industrial issues, were considerably higher at the end of the year (5½ per cent) than at the beginning (4½ per cent). They have fluctuated widely from year to year in the past, and their average at the end of 1947 was about the average level for the period 1912 to date. In contrast yields on other forms of long-term money have exhibited a marked downward trend since the early twenties. At the end of 1947 they were close to or somewhat below the levels of the late thirties and substantially below those of the twenties and early thirties.

DEMAND, PRODUCTION, AND PRICES

Domestic and foreign demands for goods and services were at exceptionally high levels in 1947 and, although production was in very large volume, inflationary forces continued dominant. Total expenditures for goods and services increased by over 20 billion dollars during the year, as is indicated in the chart, and at the close of the year were at an annual rate of more than 240 billion. Reflecting heavy demands from many sources and inadequate supplies, wholesale commodity prices rose 15 per cent during 1947 and consumer prices advanced 9 per cent. Wage rates increased further, with average hourly earnings of factory workers rising 11 per cent during the year. Real estate values in farm and urban areas remained at sharply advanced levels or rose somewhat further.



NOTE: U. S. Department of Commerce data.

In the spring of the year many buyers, who had increased their inventories considerably in 1946, withdrew from the market in the expectation of a decline in prices. As a result there were reductions during the second quarter in output of textiles, shoes, radios, and some other products. The general level of wholesale prices showed little change.

Shortages, however, persisted for many industrial products, such as steel and automobiles. Because of unfavorable growing conditions in the United States and abroad, prospects also developed for shortages of agricultural products. The Marshall Program was advanced for Federal financing of a continued large volume of exports to promote economic recovery in Western Europe, and buying by other countries was maintained in substantial volume, despite increasing dollar shortages. Demand for most types of construction expanded, although costs were at very high levels, and new shortages of building materials appeared. A sharp rise in wage rates at coal mines early in July was followed by marked advances in prices of coal and steel products. Requests were announced for large increases in freight rates, and wage rates on the railroads were raised. Veterans' terminal leave bonds, amounting to 2 billion dollars, became eligible for cashing in September.

As a result of such development, in the second half of the year widespread expectations of lower prices gave way to expectations of higher prices; demands generally expanded; and upward pressures on productive resources and on prices again increased.

Production near capacity. As the year ended the physical volume of production was close to practical limits and unemployment was negligible. Total employment increased about 3 per cent during the year and there was little change in the average number of hours worked.

Industrial production was slightly larger in December than in January 1947, according to the Board's seasonally adjusted index. Construction activity rose during 1947, but at the end of the year further expansion was limited by shortages of materials. Railroad freight traffic was in about the same volume at the end of 1947 as at the beginning of the year. Altogether, production of goods and services showed only a moderate growth from the early part of 1947 to the end of the year and the possibilities of further increase in the near future were limited.

For the year as a whole, production in most parts of the economy was larger than in 1946, a year of transition and of interruptions in activity occasioned by unbalanced supplies and important industrial disputes. Total output at factories and mines, at an average of 187 per cent of the 1935-39 average, was up 10 per cent from the 1946 average of 170, and there was nearly as much expansion in construction activity. In most other lines increases were less marked. Agricultural production, although large, was somewhat below the level of the previous year.

Rising demands. The physical volume of supplies available to the market in 1947 failed to keep pace with an unusual combination of rising demands from all sources. With supplies at the year-end only moderately larger, prices were up considerably, and total expenditures for all purposes increased about 10 per cent during the year. This situation was made possible by expanding incomes, further bank credit expansion, continued large holdings of liquid assets, and willingness on the part of buyers to spend freely even with prices at new high levels. Personal incomes were at a seasonally adjusted annual rate of 210 billion dollars in December as compared with 190 billion at the beginning of the year. Wage and salary payments rose by 10 billion dollars or 9 per cent. Farm income increased substantially. Corporate profits after taxes for the year were estimated to have been 17 billion dollars, compared with 12.5 billion in 1946, and there was a further rise in dividend payments.

The most marked increases in expenditures during 1947 were for private construction, producers' equipment, and consumer durable goods. Larger expenditures for these goods reflected higher prices as well as increases in physical volume and were facilitated by the abundant supply of credit available at low rates. An exceptional instance of this was the practice of financing new veterans' housing with mortgages written for close to the full purchase price of the properties at 4 per cent interest and running for as long as 25 years. Residential construction outlays in the fourth quarter reached a new high level for the postwar period. The increase during 1947 in expenditures for producers' equipment occurred despite the very high level of equipment outlays at the beginning of the year, as compared with other periods of high economic activity such as 1937 and 1929. Inventory accumulation by manufacturers and distributors declined during the first half of the year and apparently was below the 1946 rate of growth.

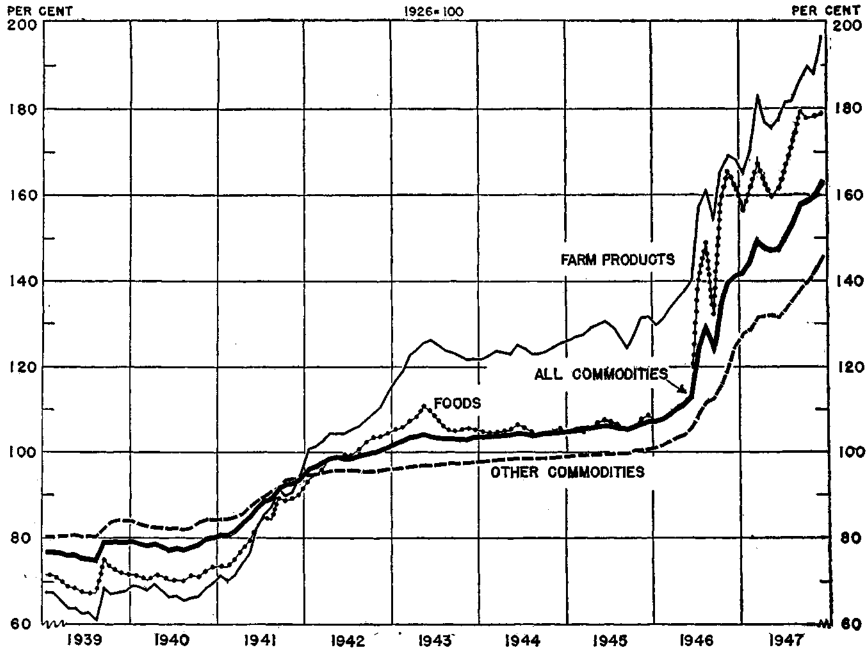
Consumer expenditures expanded about 10 per cent during the year. The increase in purchases of nondurable goods, which was less proportionally than that in outlays for durable goods, reflected higher prices, with increases in physical volume for some nondurable items offset by declines for others. Owing chiefly to the exceptionally high level of food and clothing prices, the proportion of expenditures for nondurable goods to total consumer expenditures continued to be unusually large in 1947 as compared with the relationship in prewar years. On the other hand, a smaller share of expenditures went for services in 1947, reflecting in part the maintenance of rent controls.

Government purchases of goods and services showed a moderate rise in 1947, reflecting a sharp increase in State and local expenditures. Total Federal expenditures were sustained in part by large payments to veterans, interest payments, and aid to foreign countries.

The value of recorded merchandise exports in 1947 was 14.5 billion dollars as compared with 9.7 billion in 1946 and a prewar average of 3 billion. After reaching a peak in May exports declined as dollar shortages developed and as new import restrictions abroad became effective. For some products, such as wheat, cotton, and tobacco, exports in 1947 represented 25 to 35 per cent of production, and for cotton and rayon textiles, machinery, steel, and bituminous coal, the proportions ranged from 10 to 15 per cent of production. For most other products, the share going into export markets was much smaller. Merchandise imports were in larger dollar amount than in 1946, reflecting higher prices, but were only about one-third as large as exports.

Further price advances. Prices in wholesale and retail markets continued to rise in 1947, although not so rapidly as in the latter part of 1946, when Federal price controls were lifted. Wholesale prices of farm products, foods, and other commodities were all up by about 15 per cent, reflecting the effects of generally rising demands and costs. Throughout the year prices of farm products and foods were at exceptionally high levels in relation to other prices, as is shown in the accompanying chart.

WHOLESALE PRICES



NOTE: Bureau of Labor Statistics index.

The largest increases in prices of agricultural products were in grains, reflecting the reduced harvests of feed grains during 1947, a record rate of Government purchases of wheat and flour for export, and prospects of a somewhat reduced wheat crop and continued large grain exports in 1948. As a result partly of larger consumer incomes, prices of livestock and meats in December 1947 were about 15 per cent higher than a year earlier. Cotton prices advanced somewhat during the year owing to the relatively low level of domestic stocks of raw cotton, the moderate size of the crop, and strength in the markets for cotton textile products. Prices of fruits and tobacco were adversely affected by reduced export demand, and sugar prices were held down by a very large increase in supplies.

Prices of commodities other than farm products and foods rose in the first quarter, were stable in the second quarter, and then advanced steadily during the second half of the year. In December prices of fuels, iron and steel, lumber, and leather were substantially higher than at the beginning of the year, with the largest increases in bituminous coal and in petroleum products. Large domestic requirements for fuel, limited transportation facilities, and heavy exports contributed to the marked rise in fuel prices.

Retail prices of goods and services purchased by consumers at the end of 1947 were up 9 per cent from the beginning of the year and 67 per cent as compared with prewar. Prices of foods and many other nondurable goods rose about 10 per cent and in December were double the prewar level. Housing rentals showed a rise of about 5 per cent after the middle of 1947 when controls were modified, but increases over prewar levels were still very much less than in retail prices of commodities. Utility rates also were rising at the end of the year but were still relatively low.

INTERNATIONAL TRADE AND FINANCE

In 1947, as in 1946, the immense productive power of the United States, called into action at a time when production in much of the rest of the world had not yet recovered from the ravages of war, yielded a high level of exports of goods and services and a huge export surplus. This surplus, amounting to 11.3 billion dollars in 1947 as compared with 8.1 billion in 1946, was far greater than in any previous peacetime year and only slightly below the peak attained at the height of the Lend-Lease program in 1944.

In large measure, the volume of exports and of the export surplus reflects the contribution of the United States to postwar reconstruction in war devastated areas. In addition, countries that escaped war damage and disruption, notably those in the Western Hemisphere, have made great demands upon United States production because of their high levels of domestic income, large deferred demands for many products, and the slow recovery of other sources of supply.

This large export surplus would not have been possible without major financial assistance to needy foreign countries by the United States Government. At the same time, major inroads were made upon foreign holdings of gold and dollar assets. By the end of the year, many foreign countries had largely depleted their liquid dollar resources, including lines of credit, and were facing a serious crisis in their payments relations with the United States.

While some countries are in a position to impose restrictions upon imports from the United States in order to conserve dwindling reserves of gold and dollars, many foreign areas are critically dependent upon the flow of supplies from the United States. In large measure, the volume of this flow during 1948 will be determined by the scale of financial assistance from the United States Government. It is not expected, however, that exports of goods and services or the export surplus will attain the record level reached during the past year.

Exports and imports. Recorded exports of merchandise in 1947 reached an all-time peak of 14.5 billion dollars, almost 50 per cent larger than in 1946. In addition to recorded exports, as is shown in the accompanying table, there were other exports of goods amounting to 1.5 billion dollars and receipts from services amounting to 3.6 billion. The unrecorded exports of goods consisted mainly of two items: (1) civilian supplies distributed by the armed forces ir occupied areas, amounting to over 800 million dollars (excluding freight) and (2) sales of Government surplus property located abroad, amounting tc about 200 million dollars.

The marked increase in the dollar value of recorded exports was du(mainly to the expanded physical capacity of the United States to produce foı export, but also reflected a 21 per cent increase in the average of export prices Industrial production in the United States was 10 per cent larger in 194; than in 1946, and exports of semi-finished and finished manufactures, whicl

INTERNATIONAL TRANSACTIONS AFFECTING FOREIGN GOLD RESERVES AND BANKING FUNDS IN THE UNITED STATES, 1947[1]

[In billions of dollars]

United States exports:		
Goods	16.0	
Services	3.6	
Total		19.6
United States imports:		
Goods	6.0	
Services	2.3	
Total		8.3
Net purchases of goods and services from United States by foreign countries		11.3
Sources of financing utilized by foreign countries:		
United States Government (net)—		
Credits	4.0	
Donations	1.7	
Total		5.8
United States—private (net)—		
Foreign investment (long- and short-term)	0.6	
Donations	0.7	
Total		1.3
International institutions (net)—		
Dollars disbursed by International Bank	0.3	
Dollars drawn from International Monetary Fund	0.5	
Total		0.8
Foreign countries' own capital assets (net)—		
Sales of gold to United States	2.8	
Reduction of banking funds in United States	1.2	
Liquidation of other assets in United States (long- and short-term)	0.5	
Total		4.5
Total sources of financing		12.3
Errors and omissions		−1.1

Net sales of gold to United States by foreign countries (repeated from table above)	2.8	
Foreign subscriptions in gold to International Monetary Fund	0.7	
Net gold losses by foreign countries in international transactions		3.5

[1] This table is derived largely from United States balance of payments data compiled by the Department of Commerce. However, it omits transactions between the United States and the International Fund and Bank, which, for balance-of-payments purposes, must be regarded as international areas external to the United States as well as to foreign countries; and it includes gold and dollar transactions between the Fund and Bank and foreign countries. Hence in the main table the Fund and the Bank are shown among the sources of dollars to which foreign countries have resorted in order to pay for net exports from the United States; and in the supplementary table, foreign subscriptions in gold to the International Monetary Fund are listed along with net sales of gold to the United States to show the net gold losses of foreign countries in international transactions. Details may not add to totals because of rounding.

in 1947 accounted for over 70 per cent of all recorded exports, were estimated to be 46 per cent larger, in physical volume terms, than in 1946. In the case of crude foodstuffs, the volume of exports was only moderately greater than in 1946, while in the case of crude materials and manufactured foodstuffs, the volume was actually less. The aggregate volume of recorded exports, adjusted for price changes, was estimated to be 24 per cent larger than in 1946.

Total United States imports of goods and services, amounting to 8.3 billion dollars, provided foreign countries in 1947 with dollars sufficient to pay for only two-fifths of United States exports. Recorded imports of merchandise amounted to 5.7 billion dollars, as compared with 4.9 billion in 1946, the increase being attributable entirely to the rise in import prices which occurred during the year. It appears that, in terms of physical volume, recorded imports were actually slightly smaller in 1947 than in 1946. Imports of goods and services have been a smaller proportion of national income than before the war. During the interwar period, total imports averaged about 6 per cent of the national income, but in 1947 the corresponding figure was only about 4 per cent. This smaller proportion of imports is primarily a reflection of production and supply difficulties abroad, particularly in Europe, rather than lack of demand. Merchandise imports from Europe, which in the interwar years accounted for between 40 and 50 per cent of all imports of goods by the United States, amounted to only 14 per cent of such imports in 1947.

Before the war, United States trade was characterized by an export surplus of goods and by an import surplus of services. Also, while total sales of United States merchandise to foreign countries regularly exceeded total purchases from abroad, an export balance in merchandise trade with Europe, Africa, and the rest of North America was offset in substantial measure by an import balance with Asia and with South America. In 1947, however, United States sales, both of goods and of services, exceeded purchases in the case of every major area. Recorded exports and imports of merchandise, by areas, are shown in the following table.

UNITED STATES BALANCE OF RECORDED MERCHANDISE TRADE, BY AREAS, 1947
[Dollar items in millions]

Area	Recorded exports	Recorded imports	Net recorded exports	Imports as a percentage of exports
Northern North America	$2,132	$1,130	$1,002	53.0
Southern North America	1,714	1,022	692	59.6
South America	2,358	1,237	1,121	52.5
Europe	5,214	819	4,395	15.7
Asia, Oceania	2,242	1,205	1,037	53.7
Africa	822	327	495	39.8
Total	14,482	5,740	8,742	39.6

In the case of Europe, sales of goods to the United States were sufficient to pay for less than one-sixth of the recorded merchandise exports received from this country. For Asia and the various areas in the Western Hemisphere, the corresponding proportion was one-half or more. Of the total recorded merchandise export surplus, about half was accounted for by net exports to Europe, about a third by net exports to Western Hemisphere countries, and the remainder by net exports to Asia, Oceania, and Africa.

Means of financing export surplus. As may be seen from the table on page 33, about half the over-all export surplus of goods and services was financed by loans and gifts from the United States Government, and about two-fifths was financed by the liquidation of foreign-owned gold and dollar assets. The remaining net exports were paid for with dollars secured from private United States investments and gifts and, to a smaller extent, from loans by the International Bank and the International Monetary Fund. European countries received the great bulk of loans and gifts forthcoming from Government and private sources, but nonetheless had to liquidate gold and dollar assets on an extensive scale in order to pay for imports. Countries in the Western Hemisphere paid for most of their net imports from the United States with dollars acquired from their exports to other areas and from the liquidation of gold and dollar assets.

During 1947, the United States Government made net donations ("unilateral transfers") to foreign countries amounting to 1.7 billion dollars. More than half of this consisted of transfers of civilian supplies to areas occupied by United States armed forces, and was financed from Department of the Army appropriations.

In addition to outright donations, the United States Government in 1947 made net disbursements on foreign loans amounting to 3.9 billion dollars. By far the largest component was the 2.9 billion dollars advanced to Britain under the terms of the Anglo-American Financial Agreement of 1946. Drawings on the British loan were particularly large during July and August, when Britain temporarily restored limited convertibility of the pound sterling. By the end of the year, all but 300 million dollars of the original 3,750 million line of credit had been used up. This unexpectedly rapid utilization of the British loan reflected a number of adverse factors in the development of the British balance of payments, including a marked rise in world prices, unfavorable weather conditions in the winter of 1946-47, and the insistence by most countries selling to Britain that payment be made in dollars or other convertible currencies. Most of the other Government lending in 1947 was done by the Export-Import Bank, which made net disbursements, after allowing for some repayments on earlier loans, amounting to 729 million dollars.

Private gifts and investments assisted substantially in financing net exports from the United States in 1947. The net amount of charitable contributions and personal remittances was 700 million dollars. The net outflow of private capital, amounting to 640 million dollars, consisted mainly of advances by parent companies in this country to their subsidiaries abroad.

Two international institutions, the International Monetary Fund and the International Bank, commenced active operations in 1947. The Fund, which is designed to provide short-term assistance to countries confronted with temporary balance-of-payments deficits, made its first advance in May, and during the year made a total of 464 million dollars available to its members. The Bank, which was created for the purpose of making long-term loans for reconstruction and development, began lending operations in June. By the end of the year, it had made loan commitments of about 500 million dollars and actual disbursements of 300 million.

In spite of the large foreign grants and loans made by the United States during 1947, many foreign countries found it necessary to make substantial drafts on their holdings of gold and dollar resources. Net sales of gold to the United States by foreign countries amounted to 2.8 billion dollars during the year. Foreign production (outside the U.S.S.R.), which remained at the 1946 level of about 700 million dollars, was approximately offset by the gold subscribed by foreign countries to the International Monetary Fund during the year. There appears to have been some movement of gold into private hoards in foreign countries. The total gold reserves of foreign central banks and governments are estimated to have declined from approximately 16 billion dollars at the end of 1946 to less than 13 billion at the end of 1947.

Argentina was the principal loser of gold reserves, with an estimated decline during the year of 750 million dollars. The United Kingdom and Canada also lost heavily; from the reports published by these countries concerning their total holdings of gold and United States dollars, it may be deduced that during 1947 their gold reserves declined by about 400 and 250 million dollars respectively. Among the other countries which sustained losses of gold reserves, France showed a decline during the year of 310 million dollars; Sweden, 275 million; South Africa, 175 million; the Netherlands, 160 million; and Belgium, 140 million. Only the U.S.S.R., which apparently retained most of the new domestic production, made any substantial net gain.

Drawings on dollar banking funds held in the United States by foreign countries supplied a net amount of 1,150 million dollars toward meeting foreign requirements during 1947. The dollar balances of foreign central banks and governments were drawn upon to the extent of over 1,200 million dollars net, mainly as a result of heavy drafts upon the Canadian, British, Chinese, and Italian accounts. This decline in official balances was partly compensated by a small net increase in private banking funds. At the end of the year, official balances stood at 1.8 billion dollars and private balances at 3.0 billion.

Foreign countries also made net sales to the United States of marketable dollar securities (both stocks and bonds, including United States Government bonds) amounting to 170 million dollars during 1947. The Netherlands and France were the largest sellers.

CHANGES IN BANKING STRUCTURE

Number of banking offices.[1] In 1947, for the fourth successive year, there was an increase in the number of banking offices in the United States, exclusive of banking facilities at military reservations. Net growth was not quite as large as in 1946, although considerably larger than in 1945. The figures for the four years were: 207 in 1947, 225 in 1946, 111 in 1945, and 12 in 1944. The sum of these increases is larger by about 75 than the decreases that occurred between 1939 and 1943. The total number of newly organized banks and branches was 271 in 1947, 301 in 1946, 185 in 1945, and 108 in 1944. The number that went out of existence for various reasons was about the same in 1947 as in the preceding two years. At the end of 1947 there were 18,975 banking offices (14,714 banks and 4,261 branches and additional offices). There were also 71 banking facilities at military reservations, a decrease of 8 during the year.

The number of banks (head offices) increased by 14 in 1947, as compared with 32 in 1946 and 18 in 1945. During 1947 there were 111 banks opened for business, of which 33 were member banks, 66 insured nonmember banks, and 12 noninsured banks. On the other hand, 97 banks were discontinued through consolidation, liquidation, etc.; of these, 55 became branches. The number of banks in operation at the end of 1947 was 14,714 (14,181 commercial banks and 533 mutual savings banks).

The number of branches and additional offices, exclusive of offices at military reservations, increased by a net of 193 during 1947. This compares with increases of 193 in 1946 and 94 in 1945. The number of such offices has increased every year since 1933, except when it remained unchanged in 1942.

Increase in Federal Reserve membership. Membership in the Federal Reserve System continued to increase; in 1947 there was a net gain of 23 banks as compared with gains of 16 in 1946 and 70 in 1945. The number of national banks decreased by a net of 2 and the number of State member banks increased by a net of 25. Of the 73 banks admitted to membership, 21 were national banks and 52 were State banks; of the latter, 14 were newly organized and 38 were already in operation. All but one of the 38 had previously been admitted to membership in the Federal Deposit Insurance Corporation and their total deposits amounted to about 157 million dollars. About one-half of the 73 banks admitted to membership were located in three Federal Reserve districts.

[1] In this section changes during 1947 are exclusive of changes resulting from a revision of the figures as of June 30, 1947, but end-of-year totals include such changes. The revision, which resulted in a net addition of 115 banks and 9 branches to the series, was made to bring the Board's series for banks in the United States into conformity with the revised series for all banks in the United States and its possessions announced in November 1947 by the Federal bank supervisory authorities. (See Table 15, p. 79.)

The 6,923 member banks in operation at the end of 1947 accounted for 47 per cent of the number and 85 per cent of the deposits of all commercial banks in the country. Both percentages were practically the same as in 1946. The State member banks accounted for 21 per cent of the number and 65 per cent of the deposits of all State commercial banks, the same percentages as in 1946.

Par and nonpar banks. During 1947 there was a net increase of 69 in the number of banks on the Federal Reserve Par List and a net decrease of 42 in the number of nonpar banks.[2] These changes continued the trend of several years. During the year 158 banks were added to the Par List, 2 were withdrawn, and 87 banks formerly on the list terminated existence. Of the 87 discontinued par banks, 80 were absorbed by other par banks and 53 of the 80 were converted into branches. There were net increases of 10 or more par banks in two States, Texas (23) and Georgia (12).

At the end of 1947 there were 12,037 banks remitting at par and 2,041 nonpar banks; the latter represented only 14 per cent of all banks on which checks are drawn and held a very small portion of the deposits of all commercial banks in the country. Of the 4,090 branches of commercial banks in existence at the end of the year, 3,823 were remitting at par.

All banks in 27 States and the District of Columbia are on the Federal Reserve Par List and the number of nonpar banks in each of 5 other States was less than 10. Approximately 99 per cent of the banks not on the Par List were in the following 16 States: Minnesota 413, Georgia 280, Mississippi 167, Arkansas 129, North Carolina 118, Alabama 110, Wisconsin 109, Louisiana and North Dakota 102, South Dakota 101, Tennessee 99, South Carolina 93, Missouri 68, Florida 63, Texas 60, and Oklahoma 10.

Check routing symbols. Pursuant to the program inaugurated by the American Bankers Association and the Federal Reserve System in June 1945, further progress was made during 1947 in the use of routing symbols on checks to facilitate their collection.

Approximately 96 per cent of the banks on the Federal Reserve Par List as of December 1, 1947 have had check routing symbols printed on some of their checks in the approved location, i.e., in the upper right-hand corner. On the basis of a survey made in December 1947, it was found that 46 per cent of all checks clearing through Federal Reserve Banks carried routing symbols in the approved location.

Designation of reserve cities. The Federal Reserve Act, Section 11(e), empowers the Board to add to or reclassify central reserve and reserve cities or to terminate their designation as such. Late in 1947, after consideration over

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[2] The Federal Reserve Par List comprises all member banks, which are required under the law to remit at par for checks forwarded to them by the Reserve Banks for payment, and also such nonmember banks as have agreed to do so. The revision referred to in the preceding footnote, although it added 115 banks that had not previously been included in the all-bank series, added only 11 par and 3 nonpar banks that had not previously been included in par and nonpar statistics. These additions are not included in figures describing changes during the year but are included in year-end totals.

a long period, the Board of Governors adopted a standard or basis for the classification of these cities.

On October 24, 1947, the Board published in the *Federal Register* notice of a proposed action with respect to the reclassification of certain cities. In accordance with the notice, a number of banks submitted letters, and representatives of banks in a number of the cities whose status would be changed appeared before the Board and presented their views.

After due and careful consideration of relevant matter presented, the Board concluded that a logical, fair, and appropriate standard for determining the designation and termination of reserve cities is one determined (1) by the ratio of interbank demand deposits held by member banks in each city to the aggregate amount of interbank demand deposits held by all member banks of the Federal Reserve System, and (2) by such a ratio in combination with a ratio of interbank demand deposits held by member banks in each city to the aggregate amount of all demand deposits held by member banks in such city. The Board also concluded that the standard should be applied at three-year intervals.

In accordance with these conclusions, the Board adopted a basis for classification of central reserve and reserve cities to become effective March 1, 1948, in effect as follows:

Central reserve cities. The cities of New York and Chicago are classified (and continued) as central reserve cities.

Reserve cities:

1. The City of Washington, D. C. and every city except New York and Chicago in which there is situated a Federal Reserve Bank or a branch of a Federal Reserve Bank are classified (and continued) as reserve cities.
2. Every city in which, on the dates of official call reports of condition in the two years ended June 30, 1947, member banks of the Federal Reserve System, exclusive of their offices in other cities, held an aggregate amount of demand deposits owing to banks equal, on the average, to one-third of one per cent or more of the aggregate amount of demand deposits owing to banks by all member banks of the Federal Reserve System.
3. Every city in which, on the dates of official call reports of condition in the two years ended June 30, 1947, member banks of the Federal Reserve System, exclusive of their offices in other cities, held an aggregate amount of demand deposits owing to banks equal, on the average, to one-fourth of one per cent or more of the aggregate amount of demand deposits owing to banks by all member banks of the Federal Reserve

System and also equal, on the average, to 33⅓ per cent or more of the aggregate amount of all demand deposits held by member banks in such city.

4. The Board of Governors, prior to March 1, 1948, will also designate (and continue) as a reserve city, any city now classified as a reserve city (although not within the scope of paragraphs 1, 2, or 3 above) if a written request for the continuance of such city as a reserve city is received by the Federal Reserve Bank of the district in which the city is located on or before February 16, 1948 from every member bank which has its head office or a branch in such city (exclusive of any member bank in an outlying district of such city permitted by the Board of Governors to maintain reduced reserves) together with a certified copy of a resolution of the board of directors of such member bank duly authorizing such request.
5. Effective as of March 1 of each third year after March 1, 1948, the Board of Governors will reconsider the designations according to the standards outlined above.

In accordance with paragraph 4 above, requests for continuance of reserve city status were received from member banks in nine cities which would otherwise have been discontinued as reserve cities; and, acting pursuant to that paragraph, the Board classified and continued those cities as reserve cities.

As the result of Board action, the following changes were made in the classification of reserve cities, effective March 1, 1948: the city of National City (National Stock Yards), Illinois was classified as a reserve city, and the designations of the following cities as reserve cities were terminated: Grand Rapids, Michigan; Ogden, Utah; and Spokane, Washington. The Board's action resulted in a net reduction in required reserves of member banks of less than one million dollars.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

Continuation during 1947 of the high level of banking activity, with generally expanding loan portfolios, brought increasing responsibilities to bank managements and supervisory authorities.

Total loans of all commercial banks in the United States increased during the year by 7.1 billion dollars, reaching 38.2 billion at the end of 1947. At a time when national output and employment are close to a maximum limit, an increase in the total loans of the banking system makes for inflation, even though any particular bank may have contributed little or nothing to such an outcome. This was recognized in the joint statement issued on November 24, 1947 by the Board of Governors, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Executive Committee of the National Association of Supervisors of State Banks. The statement stressed the need for bankers, as a means of combating inflationary developments, to exercise extreme caution in their lending policies and to confine their extensions of credit, so far as practicable, to productive purposes.

The prime responsibility for maintaining any bank in sound condition rests by law and logic upon its directors and managing officers. Bank supervisory authorities have the function of pointing out to bank management, as occasion requires, what appear to be elements of risk and weakness in bank assets and management, and any adverse banking trends. The extent to which each bank reduces and eliminates undue risks and weaknesses, and adapts its policies to changing conditions and foreseeable trends, determines, to a major degree, the collective strength of the nearly 15,000 banks in the American banking system. Assets of individual banks may be sound but, paradoxically, the aggregates of specific types of assets held by the banking system may at times reach proportions dangerous to the system as a whole and thus affect an individual bank. Such situations have arisen in the past, and can develop again.

Past experience has clearly shown that many problems and subsequent losses have their origin in assets acquired during boom conditions such as prevailed during 1947. High levels of business activity tend to obscure underlying weaknesses in bank assets and to increase the difficulty of their proper appraisal both by examiners and by managements.

During the year there were some instances of deterioration in the quality of loan portfolios, particularly in cases where the managements aggressively expanded loan accounts. Although such cases were scattered geographically and fairly limited in number, they were the cause of concern inasmuch as they evidenced an apparent willingness to take undue risks.

The volume of loans in State member banks adversely classified during the year was small in the aggregate, but in an increasing number of instances the examiners pointed out hazards in certain loans or groups of loans unless conditions continued to be favorable.

In recent years bank credit has been extended in a period of generally rising prices enabling many credit lines, weak when made, to be paid out without loss. It seems probable that this fact may not be fully realized by some of the younger credit men in banks and by newcomers in the field of bank management who are not conditioned by experience to visualize the problems of working out credit extensions under less favorable and more variable economic conditions. The problem of maintaining adequate and capable credit and loan supervisory staffs in banks has been accentuated also by the retirement from active duties of many older bankers. Because of the apparent lack of appreciation on the part of some banks of the necessity for maintaining adequate and current credit data, supervisory stress was continued on the need for such information and the importance of close supervision of all credit lines.

Continuation of the shift from large holdings of cash and United States Government securities into other assets, largely loans, in many cases accentuated the need for larger aggregate capital to offset the expansion in risk assets and the high level of deposits. In many banks, increasing costs of operations reduced the proportion of earnings available for this purpose. Some State member banks sold new common stock but others, in need of additional capital, have seemingly been reluctant to issue stock notwithstanding favorable conditions, or have professed inability to raise capital locally. In such cases it is incumbent upon management to exercise proper restraint in credit policies in order to maintain a reasonable relation of capital to risk assets.

During the year the Board requested each Federal Reserve Bank to review cases of State member banks in its district in which the Reconstruction Finance Corporation owned preferred capital, with a view to developing concrete plans for retiring as much as possible of such capital where it could be done on a basis consistent with the public interest. Investment of Government funds in bank capital was an emergency and temporary measure made necessary by the Banking Holiday in 1933, and was not intended to become a permanent arrangement. It was thought that private investment funds were generally available to supply the capital needs of banks, and that banks should rely thereon for their full requirements.

During the year the Board maintained formal and informal contacts on matters of mutual supervisory interest with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the National Association of Supervisors of State Banks.

Examination of Federal Reserve Banks. The Board's Division of Examinations examined each of the twelve Federal Reserve Banks and their twenty-four branches during the year as required by law.

Examination of State member banks. State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to have at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. The 1947 program for the examination of State member banks was substantially completed. In order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking authorities or alternate examinations are made by agreement with State authorities.

The annual convention of the National Association of Supervisors of State Banks held in Washington September 23 through 26 afforded a convenient occasion for the holding of the annual conference of representatives of the bank examination departments of the twelve Federal Reserve Banks. The conference was held in the Board's offices in Washington on September 22, 23, and 26, allowing representatives of the Reserve Banks and of the Board to attend the open sessions of the convention of the Association and discuss matters of mutual interest with the State bank supervisors. In view of the problems affecting the supervisory activities of the Board and the Reserve Banks, emphasis of the conference was placed upon the supervisory aspects rather than the more detailed aspects of examination procedure. Representatives of the Insurance and Protective Committee of the American Bankers Association and The National Association of Bank Auditors and Comptrollers addressed the conference.

Bank holding companies. During 1947 the Board acted upon applications for voting permits submitted by holding company affiliates of banks and authorized the issuance of six permits for general purposes and five permits for limited purposes.

The regular annual reports were obtained from holding company affiliates to provide information with respect to the organizations to which voting permits have been granted. As in previous years, a substantial number of the holding company affiliates were examined during the year by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

Section 301 of the Banking Act of 1935 provides that the term "holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to seven organizations.

The existing statutes do not provide adequate means for regulation of bank holding companies. As discussed elsewhere in this report, recommendations have been made by the Board with a view toward the strengthening of such regulation.

Trust powers of national banks. During the year, 14 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11 (k) of the Federal Reserve Act. This number includes the grant of additional powers to one bank which previously had been granted certain trust powers. Trust powers of 11 national banks were terminated, 9 by voluntary liquidation or consolidation and 2 by voluntary surrender. At the end of 1947, there were 1,785 national banks holding permits to exercise trust powers. A list of such banks, with indication of the power or powers each bank is authorized to exercise, will be supplied to those requesting it.

Acceptance powers of member banks. One application by a member bank for increased acceptance powers, made pursuant to the provisions of Section 13 of the Federal Reserve Act, was received during the year and approved by the Board.

As was mentioned in the *Annual Report* for 1946, the Reserve Banks reviewed the list of member banks in their districts holding increased acceptance powers to ascertain whether in such cases the additional powers were needed. The powers had been granted many years ago in most cases and, at the end of the year, there was a cumulative aggregate of 59 voluntary surrenders of such powers.

At the end of the year, 93 member banks held authority granted by the Board to accept drafts or bills of exchange to an amount not exceeding at any one time, in the aggregate, 100 per cent of the bank's paid-up and unimpaired capital stock and surplus, and 30 member banks (29 of which also held 100 per cent acceptance powers) held authority granted by the Board to accept drafts or bills drawn to furnish dollar exchange.

Foreign branches and banking corporations. During 1947 the Board approved 11 applications made by member banks pursuant to the provisions of Section 25 of the Federal Reserve Act for permission to establish foreign branches. Member banks opened 9 foreign branches during the year, distributed geographically as follows: Brazil 1, Germany 2, Japan 3, Philippines 3. No foreign branches were closed. Branches operating in Germany and Japan are restricted as to the types of banking operations conducted by the terms of the licenses issued by the military occupation authorities.

At the end of 1947, seven member banks were operating a total of 82 branches in 22 foreign countries and possessions of the United States. Of the 82 branches, four national banks were operating 76, and three State member banks were operating 6. The foreign branches were distributed geographically as follows:

Latin America		43
Argentina	10	
Brazil	5	
Chile	2	
Colombia	3	
Cuba	16	
Mexico	1	
Panama	3	
Peru	1	
Uruguay	1	
Venezuela	1	
Continental Europe		4
Belgium	1	
France	1	
Germany	2	
England		10
Far East		14
China	2	
Hong Kong	1	
India	2	
Japan	4	
Philippines	4	
Singapore	1	
U. S. Possessions		11
Canal Zone	4	
Puerto Rico	7	
Total		82

No change occurred during the year in the list of the five corporations organized under State laws which operate under agreements entered into with the Board pursuant to Section 25 of the Federal Reserve Act relating to the investment by member banks in the stock of corporations engaged principally in international or foreign banking. These corporations are: First of Boston International Corporation, French American Banking Corporation, International Banking Corporation, Morgan & Cie. Incorporated, and Bankers Company of New York. Two of the five have no foreign branches, one operates a branch in England, one operates a branch in France, and one has an English fiduciary affiliate.

There is in operation one banking corporation, The Chase Bank, organized under the provisions of Section 25(a) of the Federal Reserve Act to engage in international or foreign banking. The bank has a fiduciary affiliate in England and operates a branch in France, two branches in China, and a branch in Hong Kong. Its head office was examined during the year by the Board's Division of Examinations.

CHANGES IN REGULATIONS OF THE BOARD OF GOVERNORS

Margin requirements for purchasing securities. As stated in the Board's *Annual Report* for 1946, the Board's Regulation T, entitled "Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges," and Regulation U, entitled "Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange," were amended effective February 1, 1947, to reduce margin requirements from 100 per cent to 75 per cent, both for purchases of registered securities and for short sales.

Consumer credit. The Board's Regulation W, relating to consumer credit, ceased to be operative after November 1, 1947, in accordance with a resolution of Congress approved on August 8, 1947.

LITIGATION

Suit regarding removal of bank directors. The Supreme Court of the United States on January 6, 1947, sustained an order of the Board, issued under Section 30 of the Banking Act of 1933, removing from office two directors of a national bank in Paterson, New Jersey, on the basis of a finding by the Board that the directors had violated Section 32 of the Banking Act of 1933. The opinions of the Supreme Court were published in the Board's *Annual Report* for 1946, and also appear in 329 U. S. 441 and 67 S. Ct. 411.

Conviction for violating Regulation W. The United States Circuit Court of Appeals for the Sixth Circuit on April 7, 1947, affirmed the judgments of the District Court, described in the Board's *Annual Report* for 1946, adjudging Consumers Home Equipment Co. and A. B. Chereton, its President, guilty of contempt for violating an injunction issued by the District Court restraining the defendants from violating the Board's Regulation W. Certiorari was denied by the United States Supreme Court on June 23, 1947. The opinion of the Court of Appeals was published in the *Federal Reserve Bulletin* for May 1947 at page 532, and also appears in 161 Fed. (2d) 360.

Suit regarding condition of membership. In the suit of the Peoples Bank, Lakewood Village, California, against the individual members of the Board, described in the Board's *Annual Report* for 1946, the United States Court of Appeals for the District of Columbia on April 14, 1947, reversed the District Court which had refused to enjoin the members of the Board from enforcing a condition of membership imposed upon the bank at the time of its admission to the Federal Reserve System. The Court of Appeals by a divided vote held that the condition was invalid if construed literally. However, the Court held that if the condition were construed in the manner stated in its opinion, there would be no inconsistency between it and the statute. The Court therefore remanded the case to the District Court for the entry of a judgment so construing the condition and denying the injunction. The United States Supreme Court granted certiorari; and on March 15, 1948, with two Justices dissenting, the Supreme Court reversed the judgment on the ground that the plaintiff's grievance was too remote, insubstantial, and speculative in nature to justify consideration by the courts. The opinions of the Court of Appeals were published in the *Federal Reserve Bulletin* for May 1947 at pages 533-540, and also appear in 161 Fed. (2d) 636. The opinions of the Supreme Court were published in the *Federal Reserve Bulletin* for April 1948.

LEGISLATION

Purchase of Government obligations by Federal Reserve Banks. An Act approved April 28, 1947, amended Section 14(b) of the Federal Reserve Act to authorize until July 1, 1950, the purchase or sale by Federal Reserve Banks, directly from or to the United States, of bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed as to principal and interest, provided the aggregate amount acquired directly from the United States held at any one time by the twelve Federal Reserve Banks shall not exceed 5 billion dollars. Similar authority granted by an amendment to Section 14(b) which was contained in the Second War Powers Act had expired on March 31, 1947.

Federal Reserve branch bank buildings. Under a provision of Section 10 of the Federal Reserve Act, the cost of a branch bank building of a Federal Reserve Bank, exclusive of the cost of vaults, permanent equipment, furnishings, and fixtures, is limited to $250,000. This provision was amended by an Act approved July 30, 1947, to provide that the limitation shall not apply as long as the aggregate of such costs subsequently incurred by all Federal Reserve Banks for branch bank buildings with the approval of the Board does not exceed 10 million dollars.

Stock of Federal Deposit Insurance Corporation. An Act approved August 5, 1947, provided for the retirement and cancelation under certain conditions of the capital stock of the Federal Deposit Insurance Corporation, including both that subscribed to by the United States and that subscribed to by the Federal Reserve Banks. The Act provided that the amount received by the Corporation for such stock should be paid in both instances to the Treasury of the United States. Pursuant to this Act, the stock subscribed to by the Federal Reserve Banks was retired and canceled on October 7, 1947.

Consumer credit. A Joint Resolution approved August 8, 1947, continued the authority of the Board to exercise regulatory control of consumer credit pursuant to Executive Order No. 8843 for a temporary period but provided that such control should not be exercised after November 1, 1947, except during the time of war beginning after the enactment of the resolution or a national emergency subsequently declared by the President.

War loan deposits. The provisions of Section 12B(h)(1) and Section 19 of the Federal Reserve Act, as amended by the Act of April 13, 1943, exempting war loan accounts of the United States from deposit insurance assessments and from member bank reserve requirements, expired on June 30, 1947, as a result of the Proclamation of the President of the United States, issued on December 31, 1946, terminating the period of hostilities of World War II.

RESERVE BANK OPERATIONS

Volume of operations. Except for checks and paper currency and coin handled, which increased to new high levels, the volume of operations at the Federal Reserve Banks generally declined again during 1947. The principal declines were in issues, redemptions, and exchanges of Government securities. The decline in Government security issues and redemptions was offset to some extent by the substantial redemptions of Armed Forces Leave Bonds subsequent to September 1, 1947. Table 5 on page 69 shows the volume of operations in the principal departments of the Federal Reserve Banks for the past five years.

Reserve Bank holdings of loans and securities during 1947 were below the 1946 levels. Average daily holdings of loans and securities and earnings thereon are given in the first table on the following page.

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1944-47

[Dollar amounts in thousands]

Item and year	Total	Discounts and advances	Acceptances purchased	U. S. Government securities, direct and guaranteed	Industrial loans
Daily average holdings:					
1944	$14,917,596	$135,459	....	$14,772,201	$9,936
1945	21,742,589	375,958	$ 22	21,363,244	3,365
1946	23,570,260	310,308	8,457	23,250,195	1,300
1947[1]	22,552,491	218,755	384	22,331,740	1,612
Earnings:					
1944	103,837	724	....	102,810	303
1945	141,631	1,977	(2)	139,553	101
1946	149,703	2,497	43	147,125	38
1947	157,823	2,195	4	155,564	60
Average rate of earnings (per cent):					
1944	0.70	0.53	....	0.70	3.05
1945	0.65	0.53	0.50	0.65	2.99
1946	0.64	0.80	0.51	0.63	2.90
1947	0.70	1.00	1.01	0.70	3.75

[1] Based on holdings at opening of business.
[2] Less than $500.

Earnings and expenses. Current earnings, current expenses, and the distribution of net earnings of the various Federal Reserve Banks are given in detail in Table 6 on pages 70-71, and a condensed annual statement since 1914 for all the Reserve Banks combined is shown in Table 7 on pages 72-73. A condensed comparative summary for all of the Reserve Banks for the years 1946-47 is given below.

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS 1947 and 1946

[In thousands of dollars]

Item	1947	1946
Current earnings	158,656	150,385
Current expenses	65,393	57,235
Current net earnings	93,263	93,150
Net additions to current net earnings	1,973	1,626
Net earnings before payments to U. S. Treasury	95,236	92,524
Paid U. S. Treasury (Sec. 13b)	36	67
Paid U. S. Treasury (Interest on outstanding F. R. notes)	75,224	....
Net earnings	19,976	92,457
Dividends paid	11,523	10,962
Transferred to surplus (Sec. 13b)	87	28
Transferred to surplus (Sec. 7)	8,366	81,467

Current earnings were 158 million dollars in 1947, or about 8 million dollars more than the year before. Current expenses increased commensurately so that current net earnings were approximately the same as in 1946. After adding profits on sales of Government securities and deducting non-current charges, net earnings for the year before payments to the United

States Treasury amounted to 95 million dollars, or about 3 million dollars more than in 1946. After payment of 12 million dollars for the dividend to member banks, as provided in the Federal Reserve Act, $36,000 to the United States Treasury under Section 13b of the Federal Reserve Act relating to industrial loans, and 75 million dollars to the United States Treasury as interest on outstanding Federal Reserve notes not covered by gold certificates pledged with the Federal Reserve agents as collateral for such notes, 8 million dollars was added to the surplus of the Reserve Banks.

Since the Federal Reserve Act does not contemplate Federal Reserve payments to the Treasury under Section 13b after cancelation of the Federal Deposit Insurance Corporation stock held by the Reserve Banks, and since the stock was retired on October 7, 1947, the $36,000 payment referred to above reflects only industrial loan and commitment operations for the period January 1 to October 7. The payments to the United States Treasury of interest on Federal Reserve notes outstanding not covered by gold certificates pledged with the Federal Reserve agents were in accordance with the Board's policy adopted in April 1947 of paying into the Treasury approximately 90 per cent of net earnings after dividends of the Federal Reserve Banks.

Foreign transactions. Continued foreign requirements for dollars resulted in a decline of approximately 2 billion dollars in 1947 in total assets held by the Federal Reserve Banks for account of foreign central banks and governments. At the end of the year dollar deposits, earmarked gold, and securities held for all such accounts, including those maintained by foreign depositors with the Federal Reserve Bank of New York acting as fiscal agent of the United States, amounted to approximately 3.4 billion dollars as compared with slightly more than 5.3 billion dollars at the end of 1946 and a high of about 7 billion dollars in September 1945. A decline of more than one billion dollars in the amount of gold held under earmark for foreign central banks and governments was largely responsible for the reduction in total assets and the remainder occurred mainly in holdings of United States Government securities and dollar deposits. There was, on the other hand, a substantial increase in the amount of gold and dollar assets held by the Federal Reserve Bank of New York for the International Monetary Fund and the International Bank for Reconstruction and Development, both of which first entered upon active operations during 1947.

Increased activity in loans to foreign central banks and governments by the Federal Reserve Banks against gold held under earmark in the Federal Reserve Bank of New York, which first became evident in 1946, continued during the past year. The total of such loans outstanding, however, declined from about 150 million dollars at the end of 1946 to about 50 million dollars at the end of 1947. Interest on these loans, which were all made for periods not exceeding three months, was at the discount rate of the Federal Reserve Bank of New York, which remained at one per cent throughout the year.

Loans against gold to five foreign central banks were outstanding at the beginning of 1947. During the year new loans were made to the central banks of six countries, while seven central banks repaid outstanding loans in full. As a result, loans against gold to four central banks were outstanding at the end of the year.

One regular foreign central bank account was opened during the year and two accounts were opened by the Federal Reserve Bank of New York acting as fiscal agent of the United States. On the other hand, three fiscal agency accounts, which were established during the war to facilitate this Government's operations abroad, were closed.

The Federal Reserve Bank of New York, as fiscal agent of the United States, continued to operate the United States Exchange Stabilization Fund in accordance with authorization and instructions from the Treasury Department, and it acted as agent for the Treasury in the administration of foreign funds control. In cooperation with the other Reserve Banks, the New York Reserve Bank also rendered service during the year to the Export-Import Bank, in its capacity as fiscal agent for the participation of commercial banks in the 200 million dollar Export-Import Bank credit to the Kingdom of the Netherlands. Acting under the Executive Order of January 15, 1934, and Treasury regulations issued thereunder, the Federal Reserve Banks continued to collect and analyze reports from banks, security brokers and dealers, and others covering the international movement of capital.

The Federal Reserve Bank of New York performed rather extensive operations during the year as depositary for the International Bank for Reconstruction and Development and the International Monetary Fund. The New York Reserve Bank was also requested, as provided in the Bretton Woods Agreements Act, to act as fiscal agent of the International Bank in connection with that Bank's first two bond issues, dated July 15, 1947.

Bank premises. Reference is made elsewhere in this report to the amendment of Section 10 of the Federal Reserve Act providing that the $250,000 limitation on the cost of branch buildings, exclusive of the cost of the vaults, permanent equipment, furnishings, and fixtures, shall not apply as long as the aggregate of such costs subsequently incurred by all the Reserve Banks, with approval of the Board, does not exceed 10 million dollars. The Board's policy under this authorization is to approve the preparation of plans for needed building construction but not to authorize commencement of construction during present conditions of inflationary pressures and shortages of labor and materials unless the need therefor is of an emergency, as distinguished from an urgent, character. The Federal Reserve Banks have been informed that this policy also applies to head-office buildings.

In September the Federal Reserve Bank of Cleveland acquired at a cost of $1,221,000 the building in which its Cincinnati Branch has occupied rented quarters since 1927. This building was constructed in 1927 by the

Cincinnati Chamber of Commerce on land owned by the Federal Reserve Bank and included certain improvements, principally a vault, constructed by the Bank when quarters in the building were leased for occupancy by the branch. Only minor alterations and repairs were necessary upon acquisition of the building, although extensive rehabilitation is contemplated when building conditions are more favorable.

The Federal Reserve Bank of Atlanta filled in the light court at its head-office building and razed an old building on property adjoining the New Orleans Branch quarters, which was purchased in 1945 as a site for a future addition. The lot will be used for loading and unloading purposes upon completion of certain improvements.

RESERVE BANK PERSONNEL

Chairmen and Deputy Chairmen. One of the three Class C directors appointed by the Board of Governors for each Federal Reserve Bank is designated annually to serve as Chairman of the Board of Directors and as Federal Reserve Agent, and another Class C director is appointed annually as Deputy Chairman. A list of the Chairmen and Deputy Chairmen is shown on page 103.

The Chairmen and Deputy Chairmen at the Federal Reserve Banks were redesignated to serve as such for the year 1947, except for the following changes:

Donald K. David, Dean, Graduate School of Business Administration, Harvard University, Boston, Massachusetts, who had been a Class C director of the Federal Reserve Bank of Boston since January 1, 1946, was appointed Deputy Chairman for the year 1947.

W. G. Wysor, General Manager, Southern States Cooperative, Inc., Richmond, Virginia, who had been a Class C director of the Federal Reserve Bank of Richmond since January 8, 1937, and Deputy Chairman since January 1, 1938, was designated Chairman and Federal Reserve Agent for the year 1947.

Charles P. McCormick, President, McCormick & Company, Inc., Baltimore, Maryland, who had been a Class C director of the Federal Reserve Bank of Richmond since August 31, 1939, was appointed Deputy Chairman for the year 1947.

Clarence W. Avery, President and Chairman, The Murray Corporation of America, Detroit, Michigan, who had been a Class B director of the Federal Reserve Bank of Chicago since November 17, 1942, was appointed a Class C director on March 6, and designated Chairman and Federal Reserve Agent for the remaining portion of the year 1947.

Paul G. Hoffman, President, The Studebaker Corporation, South Bend, Indiana, who had been a Class C director of the Federal Reserve Bank of

Chicago since November 16, 1942, was appointed Deputy Chairman for the year 1947.

Brayton Wilbur, President, Wilbur-Ellis Company, San Francisco, California, who had been a Class C director of the Federal Reserve Bank of San Francisco since July 5, 1944, was designated Chairman and Federal Reserve Agent on May 2, 1947.

Directors. A list of the directors of the Federal Reserve Banks and branches as of the close of the year is shown on pages 104-11.

The Board made the following appointments of new directors either for terms beginning January 1, 1947, or to fill vacancies during the year:

Class C Directors. Harold D. Hodgkinson, Vice President, General Manager and Chairman of Management Board, Wm. Filene's Sons Company, Boston, Massachusetts, was appointed a Class C director of the Federal Reserve Bank of Boston for the term beginning January 1, 1947.

Edward R. Stettinius, Jr., Rector, University of Virginia, Charlottesville, Virginia, was appointed a Class C director of the Federal Reserve Bank of Richmond on July 3.

Clarence W. Avery, President and Chairman, The Murray Corporation of America, Detroit, Michigan, was appointed a Class C director of the Federal Reserve Bank of Chicago on March 6.

William R. Wallace, Jr., Attorney at Law, San Francisco, California, was appointed a Class C director of the Federal Reserve Bank of San Francisco on September 30.

Branch Directors. L. Vinton Hershey, President, Hagerstown Shoe Company, Hagerstown, Maryland, was appointed a director of the Baltimore Branch of the Federal Reserve Bank of Richmond for the term beginning January 1, 1947.

W. A. L. Sibley, Vice President and Treasurer, Monarch Mills, Union, South Carolina, was appointed a director of the Charlotte Branch of the Federal Reserve Bank of Richmond for the term beginning January 1, 1947.

Thad Holt, President and Treasurer, Voice of Alabama, Inc., Radio Station WAPI, Birmingham, Alabama, was appointed a director of the Birmingham Branch of the Federal Reserve Bank of Atlanta on April 1.

W. T. Bland of Lake Jem, Florida, was appointed a director of the Jacksonville Branch of the Federal Reserve Bank of Atlanta on March 11. Mr. Bland is a citrus fruit grower and nurseryman.

E. O. Batson, President, Batson-McGehee Company, Inc., Millard, Mississippi, was appointed a director of the New Orleans Branch of the Federal Reserve Bank of Atlanta on June 24.

Ralph E. Plunkett, President, Plunkett-Jarrell Grocer Company, Little Rock, Arkansas, was appointed a director of the Little Rock Branch of the Federal Reserve Bank of St. Louis for the term beginning January 1, 1947.

Hugh M. Brinkley of Hughes, Arkansas, was appointed a director of the Memphis Branch of the Federal Reserve Bank of St. Louis for the term beginning January 1, 1947. Mr. Brinkley is engaged in farming.

Rufus Green of Duncan, Oklahoma, was appointed a director of the Oklahoma City Branch of the Federal Reserve Bank of Kansas City for the term beginning January 1, 1947. Mr. Green is engaged in ranching and farming.

Hiram S. Corbett, President, J. Knox Corbett Lumber Company, Tucson, Arizona, was appointed a director of the El Paso Branch of the Federal Reserve Bank of Dallas for the term beginning January 1, 1947.

R. B. Taylor of Adams, Oregon, was appointed a director of the Portland Branch of the Federal Reserve Bank of San Francisco for the term beginning January 1, 1947. Mr. Taylor is engaged in livestock and farm operations.

Merle G. Hyer of Lewiston, Utah, was appointed a director of the Salt Lake City Branch of the Federal Reserve Bank of San Francisco for the term beginning January 1, 1947. Mr. Hyer is engaged in livestock and farm operations.

Change in First Vice Presidents. H. N. Mangels, who had been a member of the staff of the Federal Reserve Bank of San Francisco since 1916, and an officer since 1920, was appointed First Vice President, effective January 1, 1947. Mr. Mangels succeeded Mr. C. E. Earhart, who was appointed President of the Federal Reserve Bank of San Francisco.

Staff. At the end of 1947 the total number of officers and employees of the twelve Federal Reserve Banks and their twenty-four branches was 19,364, representing a decline of 2,066 since the end of 1946. This was the fourth successive year of decline following several successive years of increase due to the great expansion in the volume of operations during the war years. The total number of officers and employees of the Reserve Banks and branches at the end of each year beginning with 1940 was as follows:

1940	11,640	1944	24,442
1941	14,083	1945	23,522
1942	19,972	1946	21,430
1943	24,741	1947	19,364

BOARD OF GOVERNORS—STAFF

Appointment of Board Member. The nomination of Lawrence Clayton of Boston, Massachusetts, to be a member of the Board of Governors of the Federal Reserve System for the unexpired portion of the term ending January 31, 1952, was confirmed by the Senate on February 10, 1947. Mr. Clayton took the oath of office on February 14, 1947.

Death of Vice Chairman Ransom. Ronald Ransom, who had been a member of the Board of Governors since February 3, 1936, and had served as Vice Chairman since August 6, 1936, died on December 2, 1947.

Staff. On December 31, 1947, the Board's staff, exclusive of those on leave without pay, numbered 504, as compared to 480 at the end of 1946.

Leo H. Paulger, Special Adviser to the Board of Governors, retired as a member of the Board's staff, under the provisions of the Federal Reserve Retirement System, April 1, 1947. He joined the Board's staff in January 1932, and served continuously as Director of the Division of Examinations until August 1946, when he was made Special Adviser to the Board of Governors.

Chandler Morse resigned as an Assistant Director of the Board's Division of Research and Statistics, effective September 5, 1947, in order to accept a position on the faculty of Williams College, Williamstown, Massachusetts.

Bonnar Brown was appointed an Assistant Director of the Board's Division of Research and Statistics, effective October 19, 1947. Mr. Brown, after two years of service at the Federal Reserve Bank of San Francisco, had been serving as Assistant Director of the Board's Division of Security Loans since July 1, 1944.

Lowell Myrick was appointed an Assistant Director of the Board's Division of Bank Operations, effective November 4, 1947. Mr. Myrick has served continuously with the Division of Bank Operations since his original appointment on December 16, 1921.

The designation of J. Leonard Townsend was changed from Assistant General Counsel to Associate General Counsel, and that of Ralph A. Young from Assistant Director, Division of Research and Statistics, to Associate Director, Division of Research and Statistics, effective December 28, 1947.

BOARD OF GOVERNORS—INCOME AND EXPENSES

The following table shows the income and expenses of the Board for the year 1947:

OPERATING SURPLUS, January 1, 1947		$ 335,294.13	
Adjustment in 1947 for expenses applicable to preceding years		119.04	$ 335,413.17
INCOME:			
Assessments on Federal Reserve Banks		2,639,666.74	
Sale of *Federal Reserve Bulletin*		12,774.02	
Sale of other publications		24,333.93	
Miscellaneous		10,491.50	2,687,266.19
			3,022,679.36
EXPENSES:			
Salaries		1,936,166.40	
Retirement contributions		135,011.64	
Traveling expenses		110,743.80	
Postage and expressage		21,896.45	
Telephone and telegraph		51,876.22	
Printing and binding		156,953.81	
Stationery and supplies		22,070.47	
Furniture and equipment, including rental		34,175.90	
Books and subscriptions		8,426.42	
Heat, light and power		30,972.28	
Repairs and alterations (building and grounds)		5,363.43	
Repairs and maintenance (furniture and equipment)		5,160.41	
Medical service and supplies		897.05	
Insurance		3,316.85	
Miscellaneous:			
Consumer finances and liquid assets surveys	$119,890.56		
Cafeteria loss	26,838.71		
All other	12,851.29	159,580.56	2,682,611.69
OPERATING SURPLUS, December 31, 1947			$ 340,067.67

In addition to the foregoing, the Board made certain expenditures on a reimbursable basis for which it received reimbursements in 1947 as follows:

Printing Federal Reserve notes	$3,051,674.00
Leased wire service (telegraph)	93,045.14
Leased telephone lines	10,162.00
Federal Reserve Issue and Redemption Division (Comptroller of the Currency)	67,619.89
Miscellaneous	14,573.38

The accounts of the Board for the year 1947 were audited by the Auditor of the Federal Reserve Bank of New York, who certified them to be correct.

RESEARCH AND ADVISORY SERVICES

The Board's research activities during 1947 continued to be directed toward analyzing current developments in the fields of money and credit, Treasury financing, production and employment, national income, prices, and international finance. Procedures for making projections of the gross national product and related factors were further developed. Investigations of the conditions affecting the availability and use of money and credit were continued and from time to time the results of special studies were released to the public.

An important feature of the research work was the study of inflationary developments in banking, business, housing, and agriculture. Members of the Board's staff assisted congressional committees which were investigating these problems and participated in public and private conferences relating to agricultural credit, home mortgage credit, national income, and productivity. Staff members also served on many interdepartmental committees concerned with the analysis of national economic developments as well as with the improvement of statistics and other information which would contribute to a better understanding of current developments. Special assistance was provided to groups preparing reports on the effects of foreign aid on the nation's resources and on domestic, economic, and fiscal problems.

Important facts concerning member bank loans to commercial and industrial concerns, determined by a sample survey as of November 20, 1946 conducted by the Reserve Banks and the Board of Governors, were published in the *Federal Reserve Bulletin* during 1947. The survey provided information of value to bankers in formulating loan policies, to commercial and industrial concerns in planning to meet their credit requirements, and to the Federal Reserve authorities in considering national credit policies.

A special survey of loans outstanding to farmers at insured commercial banks in mid-1947 was made by the Federal Reserve System, in cooperation with the Federal Deposit Insurance Corporation. This survey was similar to the Federal Reserve survey of member bank loans to commercial and industrial concerns in that it provided valuable information concerning the purpose, characteristics, geographic distribution, and prevalence of an important type of bank credit. Findings relating to various aspects of the loans were published in the *Bulletin* during the last quarter of the year.

For the second successive time, the Board of Governors sponsored a national survey of consumer finances early in the year. These annual surveys provide insight into the shifting financial positions of consumers; their purchases and plans to purchase durable goods and houses; their current attitudes and plans with regard to saving, liquid asset holdings, and investment; and their expectations as to general economic conditions. At the request of the President's Council of Economic Advisers, as well as for the information of the Federal Reserve System and the public, the second annual survey was supplemented at mid-year by an interim survey on the basis of a smaller national sample than had been used in the primary survey. In addition to supplying needed current information, this interim survey was a useful experiment in the further development of research work in this area. Both surveys were conducted for the Board by the Survey Research Center, University of Michigan, and the results were published in the *Bulletin*. A third annual survey is being conducted in the early part of 1948.

On July 1 the Board of Governors took over the conduct of a project begun under other auspices and designed to trace flows of money payments by accounting techniques. The feasibility and potential significance of annual financial statement estimates designed to reveal money inflows and outflows for various sectors of the economy had previously been demonstrated through an exploratory private study covering the years 1936-42. This study was conducted by the National Bureau of Economic Research at the suggestion of and under a grant from the Committee for Economic Development; the Board of Governors cooperated in its planning and execution. The project the Board has now undertaken aims to develop similar financial statements on a current basis, so far as that proves feasible. The first completed step in this task is a comprehensive consolidated condition statement for the banking system which relates banking assets to the money supply for selected dates from June 30, 1929 to September 23, 1947. It is expected that this balance sheet will hereafter be compiled for the end of each quarter.

Some of the Board's regular statistical series were revised, including revisions made to increase and improve the coverage of the weekly series of statistics reported by member banks in leading cities. As of June 30, 1947, a single semi-annual series of assets and liabilities of all banks in the United States and its possessions was announced by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Board of Governors. This series, compiled by the Federal Deposit Insurance Corporation, replaced the three series previously compiled and published separately by the three agencies. In December the Board inaugurated a new monthly series of assets and liabilities of all banks in the United States (excluding possessions). The series presents separate figures, which are partly estimated, for all banks, all commercial banks, and for all member banks by class of bank.

The cooperative arrangement whereby the Federal Reserve System and the Robert Morris Associates had provided annual financial statement data for manufacturing and trade concerns for the years 1939-46 continued in 1947, covering 1946 reports. This arrangement, however, has been discontinued. Similar data for analytical purposes became available in the new quarterly series compiled by the Securities and Exchange Commission and the Federal Trade Commission.

Work in the international field continued at an intensive pace as a result of the critical problems which developed in the international economic and financial relationships of the United States. A large part of the work was closely geared to the activities of the National Advisory Council on International Monetary and Financial Problems and was carried out in close collaboration with the other agencies represented on the Council. Members of the Board's staff in the international field were active in interdepartmental committees and working groups preparing material for use by the Council in connection with foreign lending activities of the United States and with operations of the International Fund and Bank. During the last months of the year they were also heavily absorbed with interdepartmental work on the European Recovery Program, especially in the preparation of legislation and documentation for submission to the Congress.

A number of special studies were prepared during the year for the Department of State covering economic and financial conditions in various foreign countries. Continuing attention was also devoted to the special problems and operating responsibilities of the Federal Reserve System in the international field.

The Board continued to cooperate in projects in the international field by supplying members of its staff for assignments abroad. The Assistant Director of the Division of Research and Statistics in charge of international matters attended the annual meeting of the Governors of the International Fund and Bank in London as a member of the United States Delegation headed by the Secretary of the Treasury. Another member of the Board's staff devoted much of his time to the development of improved monetary and banking organizations and practices in Latin American countries; he spent two and a half months in Ecuador participating in the preparation of new central bank legislation. A third spent five months in the Philippine Islands as a member of the Joint Philippine-American Finance Commission, which was charged with the preparation of a study of financial and budgetary problems of the Philippine Government. The services of members of the staff, on leave without pay, were also made available to the Military Government authorities in Germany and Korea.

The Board had numerous visitors from foreign central banks and governments, who had come to the United States on official negotiations, or for consultation with financial authorities, international organizations, bankers, and others. It also facilitated the work of visitors who had come for the study of American banking and supervisory methods and related matters.

PUBLICATIONS AND RELEASES

The demand for Board publications and releases continued to increase during the year 1947. Schools and colleges particularly made extensive use of material issued by the Board. There was considerable interest in the Board's announcement of the publication of the Federal Reserve Charts on Bank Credit, Money Rates, and Business on a monthly basis beginning in June 1947. Several periodic releases were initiated. In addition to amendments to regulations and various reprints, the following publications were issued:

FEDERAL RESERVE BULLETIN. Issued monthly.

FEDERAL RESERVE CHARTS ON BANK CREDIT, MONEY RATES, AND BUSINESS. Issued monthly, beginning in June.

MEMBER BANK CALL REPORT. Three issues, one each in April, October, and December.

PAR LIST, and list of STATE BANK MEMBERS OF THE FEDERAL RESERVE SYSTEM AND NONMEMBER BANKS THAT MAINTAIN CLEARING ACCOUNTS. Monthly supplements for each and complete list for latter in January.

LIST OF STOCKS REGISTERED ON NATIONAL SECURITIES EXCHANGES. Quarterly supplements in May, August, and November.

BANKING STUDIES (1941). Reprinted in March.

FEDERAL RESERVE CHARTS ON CONSUMER CREDIT. Published in April.

THIRTY-THIRD ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. Published in June.

RETAIL CREDIT SURVEY—1946. Published in July.

DEBITS AND CLEARINGS STATISTICS, THEIR BACKGROUND AND INTERPRETATION. Published in October.

INTERNATIONAL MONETARY POLICIES (Postwar Economic Studies No. 7) Published in October.

FEDERAL RESERVE POLICY (Postwar Economic Studies No. 8). Published in November.

THE FEDERAL RESERVE SYSTEM—ITS PURPOSES AND FUNCTIONS (Second Edition). Published in November.

FEDERAL RESERVE MEETINGS

The Federal Open Market Committee met in Washington on February 27-28, March 1, June 5-6, October 6-7, and December 9, 1947, and the executive committee of the full Committee met from time to time during the year. Under the provisions of Section 12A of the Federal Reserve Act, the Federal Open Market Committee has responsibility for determining the policies under which the open market operations of the Reserve Banks will be carried out. A record of the actions taken by the Committee on questions of policy will be found on pages 88-97 of this report.

A Conference of the Chairmen of the Federal Reserve Banks was held on December 1-2, 1947, and was attended by members of the Board of Governors.

The Conference of Presidents of the Federal Reserve Banks held meetings on February 25-26, June 4-5, October 3-4, and December 8, and the Board of Governors met with the Presidents on February 28, June 6, October 7, and December 9.

Meetings of the Federal Advisory Council were held on March 9-11, May 18-20, September 21-23, and November 16-18. The Board of Governors met with the Council on March 11, May 20, September 23, and November 18. The Council is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with and advise the Board on all matters within the jurisdiction of the Board.

During the year a conference was held at the offices of the Board of Governors in Washington by each of the following: counsel for the various Reserve Banks, Federal Reserve Bank officers in charge of examinations, and Federal Reserve Bank auditors. Other meetings participated in by representatives of the Board of Governors and of the Reserve Banks were held to discuss questions relating to international monetary and credit matters, research and credit problems and policy, Federal Reserve Bank collection systems, personnel administration, expense accounting, and System publications and public relations.

ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Federal Reserve policies during most of 1948, as in the preceding eight years, were directed toward exerting restraint on inflationary credit expansion while at the same time maintaining stability in the market for Government securities. During the late fall of 1948 and more definitely in 1949, economic developments began to reflect widespread abatement of the inflationary pressures. The adjustments evident in the economy then called for relaxation of measures of credit restraint, and accordingly the Board of Governors took prompt action to modify its policies.

Inflationary forces continued dominant in the economy during the greater part of 1948, the year covered by this Thirty-fifth Annual Report of the Board of Governors of the Federal Reserve System. Commodity prices, which had risen sharply in 1946 and 1947, advanced generally until late summer of 1948 after showing some weakness early in the year. Production increased moderately from the unusually high levels reached in 1947. Incomes continued to expand, as did expenditures for consumer goods, housing, plant and equipment, and public works. Federal Government expenditures increased as programs of international aid and military defense expanded, while personal income taxes were reduced. Businesses, farmers, home owners, and individuals continued to borrow. Further lending by banks and other financing institutions was made possible in part by widespread selling of Government securities to the Federal Reserve. However, the over-all volume of credit was checked somewhat by voluntary action by the banks as well as compulsory restraints on private credit expansion.

As the year progressed, supplies in many lines came more nearly into balance with demands and in some cases exceeded demands at prevailing prices. After August, commodity prices declined in both wholesale and retail markets. The average level of wholesale prices, which had risen 16 per cent in 1947, was no higher at the end of 1948 than at the beginning. Consumer prices rose 3 per cent in 1948 compared with 9 per cent in 1947. Toward the end of the year credit expansion slackened and persistent selling of Government bonds by nonbank investors ceased.

In the early months of 1949, further easing of inflationary pressures was reflected in a slackening in consumer buying, more general price reductions, declines in production and employment, a rise in unemployment from the very low levels of recent years, and a decline in bank credit.

FEDERAL RESERVE POLICIES UNDER CHANGING CONDITIONS

In view of the inflationary tendencies prevailing during most of 1948, as well as of the possibility of further inflation through credit expansion, the policies of the Federal Reserve System continued to be directed toward exercising as much restraint upon credit expansion as was possible under the limitations imposed by the need for supporting the market for Government securities. Notwithstanding further substantial credit growth, monetary expansion was more effectively restrained in 1948 than in any other year since before the war. The principal limiting element was the substantial surplus of the Treasury, reinforced by restrictive policies pursued by the Federal Reserve.

Early in 1949, as evidences of economic readjustment indicated less need for restrictive credit policies, the Board of Governors relaxed certain of its regulations and requirements. In March, it reduced margin requirements on security loans by brokers and banks, fixed in Regulations T and U, from 75 to 50 per cent of the market value of the collateral securities (in May it made a further change permitting a 25 per cent margin in the case of securities acquired through the exercise of subscription rights when certain specified conditions are followed). In March and again in April, it amended Regulation W, governing consumer instalment credit, to reduce minimum down payments on articles other than automobiles and to increase the maximum period permitted for repayment of all credits under the regulation. The April amendment also raised the specific exemption in terms of sales price of articles covered by instalment contracts. In April, the Board also reduced reserve requirements by 2 percentage points on demand deposits at member banks in central reserve cities, by 1 percentage point on demand deposits at all other member banks, and by one-half percentage point on time deposits at all member banks. The effect on the money market of this reduction was offset, however, because banks sought, and Federal Open Market Committee policy of maintaining short-term rates required, sales of securities from the System's portfolio. In anticipation of the expiration on June 30 of the remaining temporary reserve authority, releasing the residue of approximately 800 million dollars of reserves, the Open Market Committee on June 28 modified its policy so that reserves thus released or accruing later might have effect in the money market. In taking all of these steps, the Federal Reserve authorities acted in conformity with a long-established policy of administering credit controls in a flexible manner so as to meet changes in economic conditions.

The Treasury cash surplus exerted some drain on bank reserves during the first quarter of 1949 but the amount was much less than in the same period of 1948. Banks were under relatively little pressure and such reserves as were needed were readily available. After March, the money market became easier. Many banks increased their holdings of Treasury bonds in the first quarter and subsequently there was also a demand for short-term Government securities. Bond yields declined slightly and shorter term money rates became less firm even at their relatively low levels.

The banking system has emerged from the long period of inflationary pressures exceptionally well equipped to meet changed conditions. Banks have a large proportion of their assets in liquid and riskless form. Loans are close to record volume but cash and Government securities constitute about two-thirds of all assets of commercial banks. This is a somewhat larger proportion than in 1939 and more than twice that for 1929. The volume of highly speculative loans appears much smaller than has often been the case in the past. Mortgage loans, which have expanded rapidly on the basis of high property values, are generally on a better amortization basis than was previously customary, and a large portion of them are insured by Government agencies.

The Federal Reserve System is also much better equipped than ever before to meet the credit needs of the economy in a period of downward readjustment. Through open market operations, the System has virtually unlimited means of supplying the money market with additional reserves, if the situation should call for such action. The Reserve Banks have about 23 billion dollars of gold certificate reserves, only half of which are currently needed to meet gold reserve requirements. Accordingly, the System could more than double its note and deposit liabilities. Furthermore, the Banking Act of 1935, by removing some of the technical limitations on the lending functions of the Reserve Banks, placed them in a position to lend to member banks on any assets considered to be acceptable as security for advances. This makes possible a liberal lending policy on the part of the Reserve Banks. Also, the Reserve Banks have authority to make so-called Section 13b loans for working capital purposes to business and industry when other credit is unavailable.

Although the Federal Reserve System has substantial powers to act for the purpose of counteracting contraction of credit, the System continues to lack adequate means of coping with a recurrence of strong inflationary pressures. This country has a virtually unlimited potential for further increase in deposits and bank reserves as well as for a more rapid use of money. The volume of deposits and currency outstanding is nearly three times the maximum prewar level, and the turnover of bank deposits is currently less rapid than it has been in previous periods of high economic activity. Spending for all purposes could be considerably expanded through more active use of the money supply already outstanding.

The problem of exercising credit restraint in the United States, or of encouraging expansion, centers on the supply of bank reserves. While individual banks obtain or lose reserves largely through the shifting of deposits among banks, the banking system as a whole acquires reserves in three major ways: imports of gold, return of currency from circulation, and purchases of Government securities by the Federal Reserve Banks. If credit expansion, during a period of inflation, is to be held in check, additional reserves arising principally from these sources have to be absorbed or immobilized.

Commercial banks alone hold more than 60 billion dollars of marketable Government securities, which they can convert at will into reserves capable of supporting an enormous credit expansion. The exceptional and assured liquidity of the banking system, which is an element of strength in a period of recession, can be a source of danger in a period of boom. Also, sales of securities to the Federal Reserve from the large volume of nonbank holdings can create additional reserves.

As the Board has pointed out in previous Annual Reports and other statements, large-scale selling of Government securities to the Federal Reserve increases the supply of money and of bank reserves and thus accentuates inflationary pressures when production is insufficient to satisfy demand. Continuous market transactions aggregating large amounts are inevitable in view of the large volume of marketable Government securities outstanding and the wide distribution of their ownership. Therefore, regular and active participation in the market by the Federal Reserve is necessary for the maintenance of orderly conditions and the prevention of unnecessarily wide fluctuations in prices.

In earlier periods, when the public debt was a relatively small part of the debt structure, there was little or no need for supporting the market for Government securities and, therefore, no problem of dealing with additional bank reserves created through support operations. Federal Reserve policies could be and were directed primarily toward the maintenance of the volume of bank reserves and the cost of obtaining reserves at levels that conformed to the current needs of the economy. With a large Government debt which is likely to be a dominant part of the debt structure for many years, the Federal Reserve has to cope with the dual problem of maintaining an orderly Government security market and exercising control over the volume of bank reserves.

LEGISLATIVE PROPOSALS

Proposals for legislation which the Board has repeatedly presented to the Congress have been in general designed to enable the Federal Reserve authorities to meet more effectively the responsibilities placed with the System by the Congress.

Power to increase reserve requirements. In its Annual Reports and other public statements since the end of the war, the Board of Governors has stressed the limited effectiveness of the traditional instruments of credit policy in the general monetary situation created by war finance. In August 1948, the Congress granted temporary authority for increasing the reserve requirements of member banks. This temporary authority expired on June 30, 1949.

In his Economic Report for 1949, the President pointed out that the monetary authorities should at all times be in a position to carry out their traditional functions of exerting effective restraint upon excessive credit expansion in an inflationary period and conversely of easing credit conditions in a time of deflationary pressures. The powers of the Federal Reserve to exert effective restraint on credit expansion are limited by the obligation to support the market for Government securities. In order to be in a better position to discharge its responsibility for maintaining sound credit conditions, the Board requested continuation of the temporary authority to apply a supplemental reserve requirement to member banks, and the extension of the requirement to all insured banks.

The Board recognized that the proposed supplemental reserve requirement was not the perfect or final way of providing the Federal Reserve with adequate means to perform its primary function. It was proposed as an interim authority that could be used, if necessary, without making drastic changes in existing practices, until a more fundamental solution could be provided.

Chairman McCabe summarized the Board's views in a statement presented before the Banking and Currency Committee of the Senate on May 11, 1949, recommending that the temporary authorities with respect to consumer instalment credit and special reserve requirements be extended, provided the latter were made applicable to all insured commercial banks. The statement continued:

> We are suggesting the extension of these authorities in the hope that the Congress will in the meantime survey the entire framework and functioning of our financial system and of the role of banking and Government therein. It is evident from the resolutions which members of this Committee have sponsored to create a National Monetary Commission that you are well aware of the need for a thorough and painstaking study of this whole complicated and difficult subject. We hope that you will press ahead to authorize such a review and reappraisal in all its ramifications of the function of the entire banking system and its role in contributing to national economic stability through the financing of individuals, business enterprises, and Government.
>
> We in the Federal Reserve System are naturally concerned over the areas of controversy that surround the System's functioning and responsibilities as a central banking, monetary, regulatory, and supervisory authority. We trust that Congress will review its delegation of authority and responsibility to the System to be sure that they are commensurate with each other and with the objectives established by Congress. Such a review would include consideration: (1) of the System's open market powers and their relation to Federal financing and the administration of the public debt; (2) of the use of selective credit controls such as those over security loans and consumer instalment loans and of the proper sphere for the application of such types of control; (3) of the distribution of bank regulatory and supervisory power among the various Government

agencies; (4) of the need for some mechanism of policy coordination on the domestic financial front such as we have available through the National Advisory Council on the international financial front; (5) of the objectives of central banking and supervisory policies; and (6) of the relation of the Federal Reserve System as a central banking organization to the banks of the nation, both member and nonmember.

In any such review the role and function of reserves will inevitably receive prominent consideration. As you know, the System has been conducting extensive studies of this subject and believes that a more scientific formula for establishing reserves can be determined by the Congress. I feel confident that solutions to these problems can be found without impairment of our long established institutions, or encroachment upon either State or national prerogatives. Indeed, it is imperative to find solutions that avoid, on the one hand, extremes of centralization which would threaten the dual banking system, or, on the other hand, jeopardize the effectiveness of national policy by disunity, discrimination, and divided counsels.

The Board feels strongly that all insured commercial banks, and not member banks alone, should participate when national monetary conditions require that additional reserves be set aside. Banks now enjoying the protection of Federal deposit insurance include 95 per cent of all commercial banks and hold 98 per cent of all deposits in commercial banks, while member banks of the Federal Reserve System include slightly less than half of the total number and hold about 85 per cent of the deposits.

The banking laws of the 48 States lack uniformity and do not take into account the relation of bank reserves to national credit and monetary requirements. It will require statesmanship of the highest order on the part of the financial community and public authorities, both State and national, to bring about a long overdue reform in all banking laws covering reserve requirements. Otherwise the dual banking system will be jeopardized, particularly in a period of emergency. Only wise action, promptly undertaken, can insure the preservation of the dual banking system.

It is inequitable to have member banks bear the entire burden of credit action undertaken in the public interest. Any expansion in reserves is likely to spread throughout the banking system and increase the lending power of nonmember as well as of member banks. Member banks already carry higher effective reserves than nonmembers, even where requirement percentages are the same. Member banks can count as reserves only their balances with the Federal Reserve Banks. Nonmember banks can count vault cash, balances with city correspondents, and, in some States, securities issued by the Federal Government or by States or their political subdivisions. Correspondent balances do not immobilize funds but simply shift lending capacity from one bank to another. Nonmember banks, nevertheless, benefit by the strength which the very existence of the Federal Reserve System gives to the entire credit structure of the country. Failure to apply national monetary measures to all insured banks seriously impairs the effectiveness of national monetary policy.

What is needed for an effective and flexible national monetary policy is a system of bank reserves that will apply to all commercial banks enjoying the benefit of Federal insurance of deposits but permit continuance of our dual Federal and State chartering and supervision of banks. Differences in reserve requirements should be based more largely on the nature of deposits than on the location of banks. It is essential, in view of the potential sources of bank reserves and possible changes in the country's credit needs, that reserve requirements for all insured banks be as uniform as practicable in order to apportion basic reserves equitably in the banking system as a whole and to regulate their amount to accommodate the needs of commerce, industry, and agriculture.

Consumer instalment credit regulation. The Congress in August 1948 also granted the Board of Governors temporary authority, which expired June 30, 1949, to reinstate controls over consumer instalment credit, and the President in his Economic Report for 1949 recommended that this authority be continued. The Board has urged that the Congress pass legislation extending this authority for an additional period of two years with the basic objective of furthering economic stability. In adapting the regulation to changing economic conditions, under a continuing authority, the Board would have in view the prevention of excessive expansion or contraction of consumer instalment credit as well as contributing to sound credit conditions in this area and in the economy generally. Modifications of the regulation, effective March 7 and April 27, 1949, are examples of the flexible use of this authority.

Considered against the long background of credit history, consumer instalment credit is relatively new. Its rapid development goes back only to World War I. It began to assume recognized importance in our credit structure towards the mid-twenties. Since that time the outstanding credit volume has shown a noteworthy growth trend, as well as wide fluctuations. Its volume at the end of 1948 stood at 8.6 billion dollars contrasted with roughly 1.2 billion in the mid-twenties.

A continuing growth trend for consumer instalment credit can be a constructive development for the economy. Sustained expansion of instalment credit has accompanied a more widespread use of durable consumer goods, especially those of high unit value, and consequently has contributed to a rising standard of personal consumption. Wide fluctuations in volume about the growth trend, however, are undesirable from the standpoint of stability. The addition of credit funds to consumer spending power from income accentuates economic upswing and at maximum limits of production can only make for inflationary pressures. Liquidation of instalment credit diverts consumer income to repayment of old debts and accentuates business downswing. In some circumstances it may seriously aggravate deflationary tendencies.

The use of instalment credit by consumers is especially volatile because it is so closely associated with the acquisition of expensive durable goods and high-priced services. For most consumers, the purchase of these goods and services is occasional. In each case the purchase represents a very important buying decision, and in most instances the decision is postponable.

While continuing fluctuations in instalment credit volume are to be expected, a moderating influence on such fluctuations can be exercised by the regulation of credit terms. During boom periods, higher required down payments and shorter maturities can damp down the rate of increase of this credit. During recession periods, smaller required down payments and longer maturities can help to brake the speed of decline. Regulation along these lines is administratively practicable, and can be exercised in a manner that is consistent with our economic and political system.

Such a regulation would not in itself enable attainment of greater financial stability for the economy. It could be, however, a useful supplement to other monetary and credit instruments available for this purpose. Established public policy in this country recognizes that broad monetary and credit controls, properly administered, are a principal means of fostering the national objective of a rising standard of living on the basis of sustained high levels of output and employment and stable values. As a result of recent war finance, the Reserve System's available means of influencing current credit developments with a view to greater economic stability have been seriously weakened. Extension of the Reserve System's temporary authority to regulate consumer instalment credit would have gone some distance toward remedying this condition.

Bank holding company legislation. The Board again urges the enactment of legislation to provide more effective supervision and control of bank holding companies and to curb abuses in that field. Congress endeavored to deal with this problem in the Banking Act of 1933 by requiring holding company affiliates of member banks to obtain voting permits from the Board in order to vote their stock in such banks. However, the Board's experience in administering the law over a period of more than 15 years has demonstrated the need for additional legislation if regulation of bank holding companies is to be effective in correcting and preventing practices which are contrary to public policy and interest.

The regulation of bank holding companies as an incident to the granting of voting permits is largely on a voluntary basis since holding companies can control subsidiary banks without voting their stock. In addition to failing to reach those companies which elect not to obtain voting permits, the present law fails to reach others because of the inadequate definition of the term "holding company affiliate." Even in those cases in which bank holding companies obtain voting permits, the law prescribes few requirements or restrictions and does not vest in the Board the authority necessary to require corrections in the policies and practices of holding companies.

Hearings on this subject were held by the Senate and House Committees on Banking and Currency of the 80th Congress and a bill was reported favorably by the Senate Committee, but no further action was taken. The Board believes the existing law is clearly inadequate and that new legislation, providing for the regulation of all bank holding companies and including provisions controlling expansion and requiring the divorcement of activities unrelated to banking, should receive prompt consideration.

Capital requirements for member banks. The Board has recommended in previous Annual Reports that consideration be given to amendment of the statutory provisions prescribing capital requirements for the admission of State banks to membership in the Federal Reserve System and the establishment of branches by such banks. Legislation of this nature is needed because, without justification, the present arbitrary requirements prevent many sound banks from becoming members of the Federal Reserve System, although they otherwise would be entitled to membership. Most of these banks are insured by the Federal Deposit Insurance Corporation. In addition, present statutory requirements result in unwarranted discrimination between State member banks and other State banks in connection with the establishment of branches. In order to correct this situation, the Board urges the enactment of legislation repealing the existing requirements and vesting full discretion in the Board to determine the adequacy of the capital of State banks applying for membership and of State member banks desiring to establish branches, except that a minimum capital of $50,000 (or $25,000 in the case of banks heretofore organized) would be required for admission to membership.

Financing of business enterprises. The Board has heretofore called attention to the fact that Section 13b of the Federal Reserve Act, which authorizes Federal Reserve Banks to make and guarantee business loans, contains undesirable restrictive provisions. In previous Annual Reports, it has recommended legislation to broaden the authority of the Reserve Banks in this field.

FEDERAL RESERVE POLICIES IN 1948

In 1948 a large Treasury surplus, a substantial part of which was used to retire Government securities held by the Federal Reserve System, absorbed bank reserves and deposits. The anti-inflationary effects on bank reserves, however, were more than offset by purchases of Government securities by the

Federal Reserve System in carrying out its market support policy. Banks were also supplied with a moderate amount of reserves through gold acquisitions and a return flow of currency from circulation. Continued expansion in bank loans provided new deposits, but this expansion was smaller than in other recent years. The net result of all factors was a small decline in bank deposits and currency held by the public—the first decrease for any year since 1937.

Policies pursued by the Federal Reserve to restrain credit expansion included the following:

(1) In consultation with the Treasury, the Federal Reserve accepted cash for maturing securities held by the System and thus prevented the return of reserves to the banking system.

(2) Likewise, interest rates on Treasury bills and certificates were permitted to rise and banks and others were thereby encouraged to hold more of these securities, which made it possible for Federal Reserve holdings to be reduced. In line with this policy, discount rates at Federal Reserve Banks were raised.

(3) Reserve requirements of member banks were increased so as to absorb additional reserves made available by the gold inflow and by Federal Reserve purchases in support of the market for Government securities.

(4) Regulation of consumer instalment credit was reimposed for the purpose of slackening the rapid rate of growth of this volatile type of credit.

(5) High margin requirements were retained on loans for purchasing and carrying securities in order to discourage the possible development of speculative credit expansion in this field.

The cash surplus of the Treasury, which was largely responsible for the reduction in bank deposits during 1948, amounted to 8 billion dollars for the year as a whole. It was supplemented by about 1.5 billion dollars obtained from sales of savings bonds and savings notes in excess of redemptions. The bulk of these funds was obtained in the first quarter of the year. The surplus was used largely to retire over 5 billion dollars of Government securities held by the Federal Reserve Banks. The Federal Open Market Committee, which directs transactions in Government securities for the Federal Reserve Banks, accepted cash for as many of the System's holdings of maturing issues as the cash position of the Treasury would permit. Occasional reduction by the Treasury in the amount of weekly offerings of Treasury bills also resulted initially in a decrease in Federal Reserve holdings of bills and some drain on bank reserves.

Rates on Treasury bills, which had been permitted to rise from ⅜ per cent in the summer of 1947 to about 1 per cent near the end of that year, rose further in the latter half of 1948 to about 1⅛ per cent. Rates on new offerings of one-year certificates, which had been raised from ⅞ per cent in 1947 to 1⅛ per cent at the beginning of 1948, were increased to 1¼ per cent in the fourth quarter of 1948. The higher rates contributed to increases in holdings of these securities, particularly bills, by both banks and nonbank investors, and in substantial declines in Federal Reserve holdings.

Policies pursued by the Federal Reserve served to limit the expansion of bank loans, but Federal Reserve purchases of Government securities from nonbank holders provided funds for an increase in loans by nonbank lenders. Also, the demand for credit slackened somewhat in the course of the year. Although measures of restraint did not prevent a further expansion in bank loans, the rate of growth slackened, particularly in the last quarter of the year, as compared with other recent years. Total loans of commercial banks increased by 4.4 billion dollars in 1948, compared with 6.9 billion in 1947.

Deposits and currency held by individuals and business declined by 6 billion dollars in the first quarter of 1948, reflecting the large Treasury surplus. They increased by more than 5 billion dollars during the remainder of the year, largely as a result of bank loan expansion, Federal Reserve purchases of Government securities from nonbank holders, and the gold inflow.

The ability of banks and other investors to sell Government securities through the market to the Federal Reserve and the large amount of securities outstanding limited the restraining effect of monetary and fiscal policies. To the extent that banks needed additional reserves, the drain on bank reserves resulting from the Treasury surplus and its use to retire securities held by the Federal Reserve was offset by bank sales of securities, which the Federal Reserve purchased. Banks were also in a position to meet increases in reserve requirements by selling Government securities.

Nevertheless, the combined measures exerted some degree of restraint. When banks find it necessary to sell Government securities in order to offset a drain on reserves resulting from Treasury withdrawals of cash or to meet an increase in reserve requirements, their liquidity is reduced and they are likely to be less willing to sell additional amounts in order to increase loans. Conversely, additional reserves flowing to banks, unless absorbed by some means, serve as an inducement to expand loans. So long as bank holdings of Government securities, particularly short-term issues, can be readily converted to other uses without the risk of loss in liquidation, they are in effect excess reserves. Thus, an increase in bank holdings of short-term Government securities expands the potential lending power of banks. Conversely, a decrease in such holdings and any measures which limit their availability serve to reduce the potential liquidity of banks.

It is primarily through the means outlined in the foregoing pages that monetary and fiscal policies may influence the lending activities of banks and also to some extent the willingness of other owners of Government securities to hold them or to shift to other assets. Whether Government securities are to be held or sold is decided by the banks and other holders of the securities. As long as the Reserve System functioned as the residual buyer of the securities offered for sale the initiative in the creation of bank credit rested with the market, not with those charged with responsibility for national monetary policy.

THE PUBLIC DEBT

Changes in the volume, structure, and ownership of the Federal Government debt continued in 1948 to be an important factor in monetary and credit developments. As in the preceding year, an excess of Treasury cash receipts over cash outlays made possible further reduction in the public debt. As the table shows, the cash surplus was larger in 1948 than in 1947, reflecting an increase in cash receipts and some decline in cash outlays. A small part of the surplus was used to increase the Treasury's cash balance, which had been drawn down during 1947. The more substantial part of the surplus was used to repay cash borrowings, principally marketable debt issues. The debt reduction thus achieved was partly offset by an increase in noncash borrowing, chiefly through special issues to Government agencies and trust funds.

Debt reduction. The total public debt outstanding was further reduced by 4 billion dollars in 1948 to a total of 253 billion at the end of the year. The reduction was larger than in 1947, when retirement of debt was

TREASURY CASH OPERATIONS AND CHANGES IN CASH BALANCE AND PUBLIC DEBT

[In billions of dollars]

Item	Calendar year		
	1948	1947	1946
Cash operating income[1]	45.0	44.3	41.6
Cash operating outgo[1]	36.9	38.6	41.4
Net cash surplus (+)	+8.1	+5.7	+0.2
Change in Treasury cash balance	+1.1	[2] −2.2	−22.5
Change in public debt:			
Net cash repayment of borrowing[3]	−7.0	−7.9	−22.7
Noncash borrowing, etc.[4]	+2.9	+5.4	+3.5
Change in debt[5]	−4.1	−2.5	−19.2
Public debt, end of period[5]	252.9	257.0	259.5

[1] The cash budget differs from the budget based on the Treasury's daily statement principally in that all receipts and expenditures are consolidated and intergovernmental transfers of funds are excluded. Refunds of taxes, which amounted to 2.2 billion dollars in 1948, 2.6 billion in 1947, and 2.8 billion in 1946, are treated as a deduction from cash income rather than as cash outgo as formerly.

[2] Includes also a decrease of 1.8 billion dollars in the Exchange Stabilization Fund in part payment of the United States contribution to the International Monetary Fund.

[3] Includes principally net changes in marketable debt, net sales or redemptions of savings bonds and savings notes, and net market sales or purchases of marketable issues by Government agencies and trust funds.

[4] Includes principally changes in special issues to Government agencies and trust funds, net accrued interest on savings bonds and Treasury bills, and amounts of Federal securities issued in payment of certain budget expenditures, such as armed forces leave bonds. Includes also small adjustment for net market sales or purchases of marketable issues by Government agencies and trust funds which do not affect total outstanding debt.

[5] Includes guaranteed debt.

also made possible by a Treasury cash surplus. The total reduction effected through cash surpluses in these two years was much smaller than that in 1946, when cash balances accumulated largely during the last war loan drive were used to reduce the debt by 19 billion dollars.

The amount of the debt in marketable form decreased by 8 billion dollars in 1948, while nonmarketable issues held by the public increased by about 2 billion and special issues to Federal agencies by nearly 3 billion. The decline in outstanding marketable securities was smaller than in 1947, but so also was the increase in nonmarketable public and special issues. Matured and other noninterest-bearing debt declined slightly in 1948 after increasing in 1947.

Composition of the debt. Composition of the Government debt has been changing gradually as the result of refunding, further sales of special issues to Government agencies, and increased efforts to place more savings bonds.

In 1948, the Treasury retired 2.9 billion dollars of bills. Maturities of other marketable issues totaled 35.5 billion dollars, including 21.2 billion of certificates, 7.8 billion of notes, and 6.4 billion of bonds. About 5.4 billion of these maturities were paid off in cash. The remainder was refunded into short-term securities which, with the exception of one 18-month note issue, were one-year certificates. As a result of the debt operations, the amount of outstanding marketable bonds was reduced by 6.4 billion dollars. Short-term types of securities were reduced by 1.8 billion. As indicated in the table, a reduction of 2.9 billion dollars in bills was partly offset by an increase of 1.1 billion in notes and certificates.

PUBLIC DEBT OUTSTANDING AT END OF 1948, BY TYPE OF ISSUE

[In billions of dollars]

Type of issue	1948	Change during		
		1948	1947	1946
Gross public debt, total[1]	252.9	−4.1	−2.5	−19.2
Marketable public issues, total[2]	157.5	−8.3	−10.9	−22.2
Treasury bills	*12.2*	*−2.9*	*−1.9*	(3)
Certificates and notes	*33.7*	*+1.1*	*−7.5*	*−21.0*
Treasury bonds	*111.4*	*−6.4*	*−1.5*	*−1.1*
Nonmarketable public issues, total	61.4	+1.9	+2.8	−0.7
Savings bonds	*55.1*	*+3.0*	*+2.3*	*+1.6*
Savings notes	*4.6*	*−0.8*	*−0.3*	*−2.5*
Other	*1.8*	*−0.3*	*+0.9*	*+0.2*
Special issues	31.7	+2.8	+4.4	+4.6
Debt bearing no interest	2.2	−0.5	+1.2	−0.9
Detail on marketable public issues, due or callable:				
Within 1 year	49.1	−1.7	−4.2	−15.6
1-5 years	44.1	−5.9	+10.4	+4.2
5 years and over, total	64.4	−0.7	−17.0	−10.8
Bank-eligible bonds	*14.7*	*−0.7*	*−17.0*	*−8.2*
Restricted bonds	*49.6*	....	....	*−2.6*

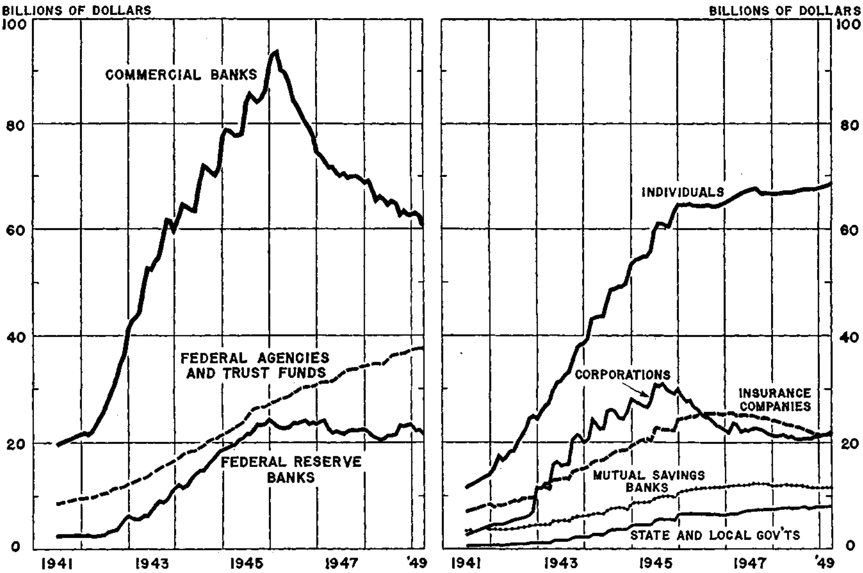
[1] Includes guaranteed securities.
[2] Includes a small amount of postal saving and prewar bonds not shown separately.
[3] Less than 50 million dollars.
NOTE: Details may not add to totals because of rounding.

The total of nonmarketable public debt issues held by the public increased further in 1948 but by a moderate amount, 1.9 billion dollars. Savings bonds outstanding increased by 3 billion dollars, as 7.3 billion of sales, together with net interest accruals on outstanding bonds, exceeded redemptions. The sales volume in 1948 resulted in part from an increase in the annual purchase limit permitted for individuals and a special drive to place savings bonds with both individuals and savings institutions.

At the end of 1948, about three-fifths of the debt of 253 billion dollars was composed of marketable issues. The remainder included 32 billion dollars of special issues held by Government agencies and trust funds, 55 billion of savings bonds held largely by individuals and redeemable on demand or short notice, and small amounts of several other types of nonmarketable issues, largely savings notes held by corporations. The marketable debt of 157.5 billion dollars included about 46 billion dollars of short-term types of securities (bills, certificates, and notes) and about 47 billion of Treasury bonds due or callable within five years. Of the 64 billion dollars of bonds with longer periods to run, almost 50 billion were issues that are restricted as to ownership by banks.

Ownership of Government securities. The largest change in ownership of Government securities during the year was the decline of 6 billion dollars in commercial bank holdings, as is shown in the accompanying chart and table.

OWNERSHIP OF U. S. GOVERNMENT SECURITIES



NOTE: Chart relates to interest-bearing debt, direct and guaranteed. Reported holdings are shown for (1) Federal agencies and trust funds and (2) Federal Reserve Banks, and Treasury estimates for other groups. Figures are for June and December 1941 and for end of each month thereafter.

The Treasury cash surplus and its use to retire Government securities held by the Federal Reserve, together with increases in reserve requirements, resulted in a drain on bank reserves which the banks met by selling Government securities, largely certificates and notes. Changes in types of securities held by the banks also reflected other factors. Holdings of Treasury bonds that matured were for the most part exchanged for certificates and notes, offsetting to this extent market sales of these types of securities. Commercial banks also sold some Treasury bonds, but they added to their holdings of bills.

Reserve Bank holdings of Government securities increased by 800 million dollars notwithstanding the policy of accepting cash for as many maturing holdings as the cash position of the Treasury would permit and the consequent retirement of 5.5 billion dollars of maturing securities. The Reserve Banks made substantial purchases of restricted bonds from insurance companies and other nonbank investors. They also bought some bank-eligible bonds and made some net purchases of certificates and notes, but sold a substantial amount of bills.

OWNERSHIP OF UNITED STATES GOVERNMENT SECURITIES[1]

[Partly estimated. Par values, in billions of dollars]

Type of owner	Amount held on Dec. 31, 1948	Change in 1948	Change in 1947	Change in 1946
U. S. Government agencies and trust funds, total[2]	37.3	+3.0	+3.4	+3.9
Marketable issues	*5.5*	*+0.2*	*−1.0*	*−0.7*
Special issues	*31.7*	*+2.8*	*+4.4*	*+4.6*
Federal Reserve Banks, total	23.3	+0.8	−0.8	−0.9
Bills, certificates, and notes	*12.4*	*−7.4*	*−2.9*	*−0.7*
Bank-eligible bonds	*4.0*	*+1.7*	*+1.5*	*−0.2*
Restricted bonds	*7.0*	*+6.4*	*+0.6*	....
Commercial banks, total	62.6	−6.1	−5.8	−16.3
Bills, certificates, and notes	*16.9*	*+0.8*	*−4.8*	*−17.9*
Bonds, due or callable:				
Within 5 years	*32.9*	*−6.0*	*+10.5*	*+7.8*
After 5 years	*10.6*	*−1.3*	*−11.3*	*−5.9*
Nonmarketable issues	*2.2*	*+0.4*	*−0.2*	*−0.3*
Mutual savings banks	11.5	−0.5	+0.2	+1.1
Insurance companies	21.5	−2.8	−1.0	+0.9
State and local governments	7.9	+0.6	+1.0	−0.2
Other corporations and associations[3]	21.2	(4)	−1.2	−7.8
Individuals[5]	67.6	+1.0	+1.7	+0.1
Total, all investors	252.9	−4.1	−2.5	−19.2

[1] Includes guaranteed securities.
[2] Includes nonmarketable issues not shown separately.
[3] Includes savings and loan associations, dealers and brokers, and investments of foreign balances and international accounts in this country.
[4] Less than 50 million dollars.
[5] Includes partnerships and personal trust accounts.

Insurance companies and mutual savings banks, which had maintained or expanded their Government security portfolios in the early postwar period, reduced them in 1948 by 2.8 billion and 0.5 billion dollars, respectively.

These changes resulted largely from sales of long-term, restricted Treasury bonds. Other nonbank investors, including nonfinancial corporations, brokers and dealers, State and local governments, and individuals increased their total holdings of Government securities during the year. They sold marketable bonds on balance, but increased their holdings of certificates and bills by about 4 billion dollars. Purchases of savings bonds exceeded redemptions.

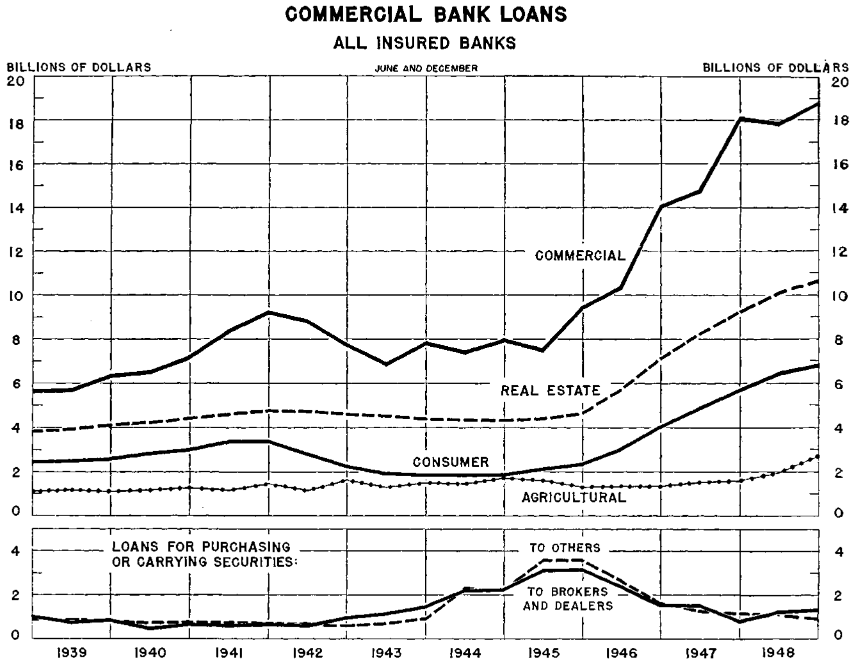
BANK CREDIT DEVELOPMENTS

The money supply in the hands of businesses and individuals declined somewhat in 1948 following a rapid growth in the preceding postwar years. The decline occurred entirely in the first quarter of the year and reflected the large Treasury cash surplus, which was either used to retire securities held by the banking system, including the Reserve Banks, or held in Treasury balances. Loan expansion at commercial banks and gold inflow, which continued during the year, accounted for a substantial growth in deposits during the last nine months. For the year as a whole, these factors almost offset the contractive effect on the money supply of Treasury operations.

Expansion of bank loans was not as great in 1948 as in either of the two preceding years. Growth in loans slackened considerably in the last quarter of the year following action by the Federal Reserve, largely under special legislation enacted in August, to absorb funds available to banks for lending and to place under restraint the demand for consumer instalment credit. Substantial amounts of loans by nonbank lenders and some decline in the credit needs of business reduced somewhat the demand for bank loans. Programs for encouraging restraint in lending, undertaken by the banks themselves under the leadership of the American Bankers Association and by the bank supervisory agencies, also helped to limit loan expansion.

Reduced growth in bank loans. Slackened expansion in 1948 characterized bank lending to businesses, consumers, and real-estate owners in all sections of the country. Total loans at commercial banks increased by about 4.4 billion dollars as compared with 6.9 billion in 1947 and over 5 billion in 1946.

Business loans, which usually decline over the first half of the year and rise in the second half, showed considerably less than the normal seasonal reduction in the first half of 1948. Early in the second half of the year rapid expansion in the volume of these loans was resumed. After September, however, bank loans to businesses showed little further growth as compared with an increase of about 2 billion dollars in the same period of the previous year. Total growth in bank loans to businesses was about 0.7 billion dollars in 1948 compared with about 4 billion in 1947, as shown in the chart. Most of the increase occurred at banks in New York City and in the Southwest and Far West, while in 1947 the increase was more general throughout the country.



NOTE: All insured commercial banks in the United States. Commercial loans include commercial and industrial loans, open market commercial paper, and acceptances. Consumer loans are partly estimated prior to Dec. 31, 1942.

Business demand for bank credit was less active in 1948 than in other postwar years, in part because a larger volume of funds was obtained from other sources. As is indicated in the following section of this report, in 1948 businesses financed a larger proportion of their capital expansion programs from retained earnings and funds obtained from sales of securities and loans from nonbank lenders than they did in 1947.

Bank loans to real-estate owners increased by about 1.4 billion dollars in 1948, which was somewhat less than in previous postwar years. The volume of new mortgages continued about as large as in 1947, but banks acquired a smaller proportion of the total. They were more selective in making real-estate loans and showed a growing tendency to regard their existing mortgage portfolios as large enough under existing conditions.

Banks continued to be active lenders to consumers in 1948, accounting for about 40 per cent of the expansion of more than 2 billion dollars in consumer instalment credit during the year. Instalment credit extended by banks to consumers expanded at the rate of about 80 million dollars each month through September 1948. In the last quarter of the year, however, this type of indebtedness showed little further change. In part, leveling off of bank loans to consumers reflected reimposition in September of the Board's regulation of consumer instalment credit under authority granted by Congress in August.

Agricultural loans at banks, which had risen only gradually in 1947 and 1946, increased by more than 1 billion dollars in 1948. Most of the growth in such loans was associated with large crop surpluses and the consequent decline in prices of leading crops to Government support levels. Many farmers obtained bank loans on wheat, corn, and cotton that were guaranteed by the Commodity Credit Corporation under the Government's price support program. Other loans to farmers showed only moderate expansion, which occurred in the first half of the year.

Loans for purchasing and carrying securities increased 300 million dollars during 1948, as a result of a sharp expansion late in the year in loans to brokers and dealers for carrying United States Government securities. Loans for purchasing and carrying corporate stocks and bonds declined somewhat.

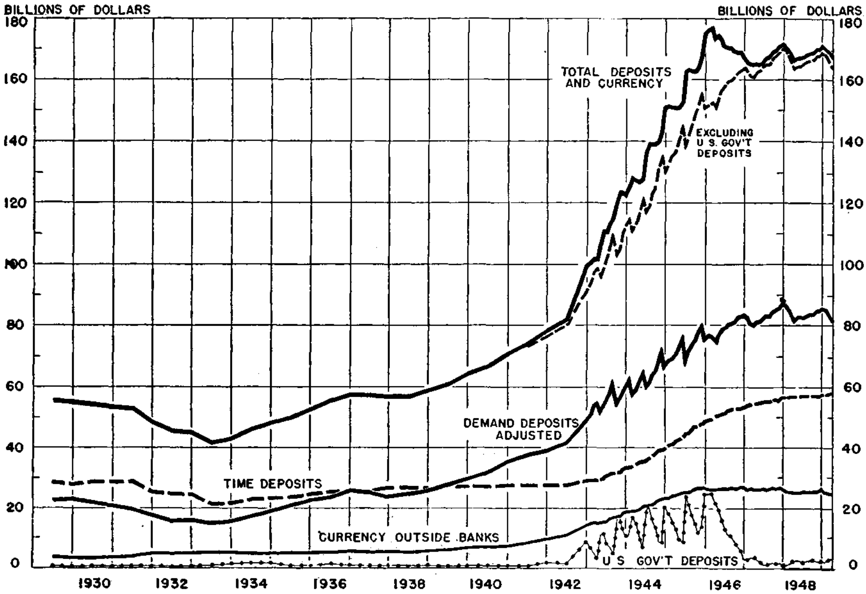
Banks participated to an almost negligible extent in the large amount of financing in the market by corporations and by State and local governments in 1948. Although the volume of such issues for new money was over 8 billion dollars, commercial bank holdings of these securities increased only about 0.2 billion dollars as compared with an increase of nearly a billion dollars in 1947. Most of the change in 1948 occurred in the first half of the year, when an increase in holdings of State and local government securities at reserve city and country banks more than offset a reduction in holdings of such securities and corporate securities at central reserve city banks.

Changes in volume and activity of money. The decline in total deposits and currency held by businesses and individuals was about 1 billion dollars in 1948. This reduction was small in contrast with the very rapid monetary expansion during the war and first two postwar years. It was the first year-to-year decline in the money supply held by businesses and individuals since 1937, as is shown in the chart.

In the first quarter of the year deposits and currency of individuals and businesses declined 6 billion dollars, as shown in the table on page 20. This decline reflected primarily seasonally large Treasury receipts from income taxes and other sources which were applied to retiring bank-held securities and building up Treasury deposit balances. In each of the subsequent three quarters, privately held deposits and currency increased somewhat. Expansion of bank credit and gold inflow more than offset some further monetary contraction effected by a moderate Treasury cash surplus.

The Federal Reserve Banks purchased in the market a substantial volume of long-term Government securities sold by nonbank investors, particularly insurance companies. These transactions were especially large in the last half of the year. During most of the year, and particularly in the first quarter, nonbank investors were net buyers of short-term Government securities, Taking all classes of Government securities, both long-term and short-term, nonbank investors were net purchasers in the first part of the year and net sellers in the second half. For the year as a whole, sales of long-term Government securities by nonbank investors as a group were practically balanced by their purchases of short-term issues. On balance, therefore, these transactions tended neither to increase nor decrease the supply of bank deposits. In the first quarter of the year, however, the effect was to reduce deposits, whereas in the last two quarters the effect was to increase deposits.

BANK DEPOSITS AND CURRENCY



NOTE: Figures are partly estimated. Deposits are for all banks in the United States. Demand deposits adjusted exclude U. S. Government and interbank deposits and items in process of collection. Time deposits include deposits in the Postal Savings System and in mutual savings banks. Figures are for June and December, 1929-42; end of month, 1943-46; last Wednesday of month, 1947 through March 1949.

Currency in circulation outside banks was reduced about 400 million dollars in 1948, with the strengthening of the postwar tendency to return $10 and $20 bills from circulation. Privately held demand deposits declined by 1.6 billion dollars in 1948 in contrast with an increase of nearly 4 billion in the previous year. Time deposits rose by 1.1 billion dollars, after having risen by 2.5 billion in 1947. In 1948 nearly the entire increase occurred in the first half of the year. The decrease in demand deposits was distributed among nearly all the major groups of holders—businesses, farmers, and individuals. Demand deposits of individuals as a group declined by an amount approximately equal to the increase in their holdings of Government securities.

MAJOR FACTORS AFFECTING DEPOSITS AND CURRENCY
[In billions of dollars, partly estimated]

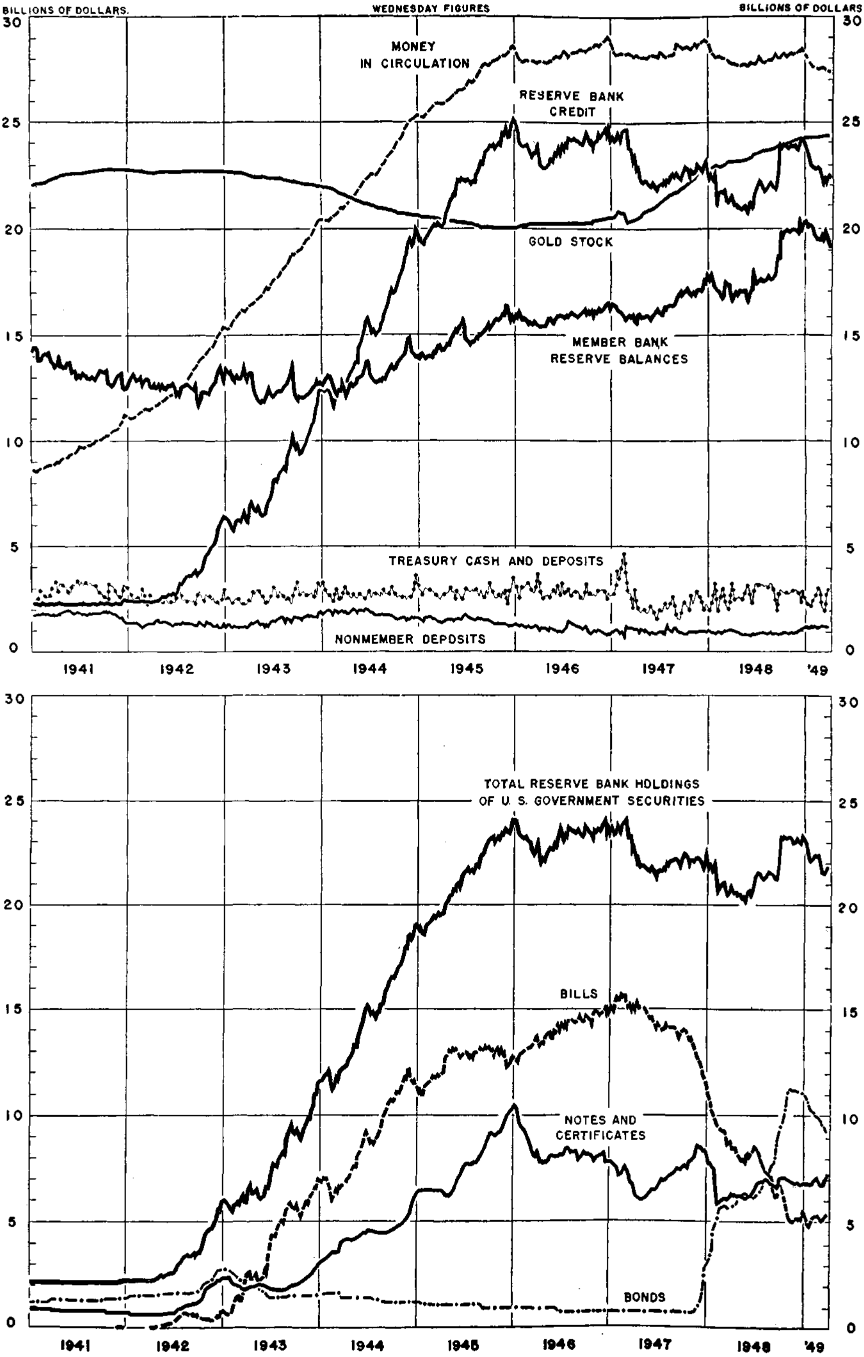
Factor	1948 Fourth quarter	1948 Third quarter	1948 Second quarter	1948 First quarter	1948 Total	1947
	(Sign indicates effect on deposits and currency)					
Bank loans[1]	+1.0	+2.0	+1.2	+0.9	+5.2	+7.4
Gold inflow	+0.4	+0.3	+0.4	+0.4	+1.5	+2.9
Purchases (+) or sales (−) of U. S. Government securities by commercial banks and Federal Reserve Banks from or to nonbank investors	+0.7	+0.8	+0.2	−1.5	+0.2	+0.2
Restricted bonds, net	*+1.5*	*+2.6*	(2)	*+1.8*	*+5.9*	*+0.6*
Other securities, net	*−0.8*	*−1.8*	*+0.2*	*−3.3*	*−5.7*	*−0.4*
Retirement of U.S. Government securities held by:						
Federal Reserve Banks	−0.4	−1.1	−0.3	−3.7	−5.5	−3.2
Commercial banks	−0.1	−0.5	−0.2	−0.2	−0.9	−3.6
Treasury deposits	+0.9	−0.4	+0.3	−2.1	−1.3	+1.2
Other factors, net	−0.3	+0.1	+0.1	+0.2	−0.1	+1.1
Change in deposits and currency held by individuals and businesses, total	**+2.2**	**+1.2**	**+1.7**	**−6.0**	**−0.9**	**+6.0**
Demand deposits adjusted	+1.6	+1.2	+1.2	−5.6	−1.6	+3.8
Time deposits	+0.2	−0.1	+0.5	+0.5	+1.1	+2.5
Currency outside banks	+0.4	+0.1	(2)	−0.9	−0.4	−0.3

[1] Includes loans of commercial and mutual savings banks.
[2] Less than 50 million dollars.
NOTE: Changes are based on figures for Dec. 31, 1946, Dec. 31, 1947, and Mar. 31, June 30, Sept. 29, and Dec. 31, 1948. Quarterly figures may not add to yearly total because of rounding.

Expenditures of all private groups in the economy continued to expand throughout 1948 despite the moderate decline in the privately held money supply. This development reflected a further increase in the average rate at which money was used. Over the three years following the end of the war, the annual rate of turnover of demand deposits at banks rose significantly. At banks in leading cities outside New York, the ratio between the amount of checks drawn on demand deposits and the amount of deposits outstanding was about one-fifth higher in 1948 than in 1945, the last war year. In fact, use of demand deposits at these banks was about as rapid in 1948 as it was on an average over the four-year period 1938-41, although the volume of these deposits was about three times as large.

Availability of bank reserves. From the end of the war, and particularly from mid-1947 until the end of 1948, Federal Reserve credit policies and Treasury fiscal and debt management programs had as a major objective as much restraint on the availability of bank reserves and therefore on monetary and credit expansion as was consistent with maintenance of orderly and stable conditions in the market for Government securities. Action toward this objective on the basis of existing powers included concentration of the Treasury program of debt retirement on securities held by the Reserve Banks, upward adjustment of rates on short-term Government securities and in the Federal Reserve discount rate, reduction in Federal Reserve support prices for

MEMBER BANK RESERVES, RESERVE BANK CREDIT, AND RELATED ITEMS



medium-term and long-term Government securities, and increases in reserve requirements on deposits of member banks.

Treasury operations exerted a contractive force on bank reserves of 5.8 billion dollars in 1948, as is shown in the table. Most of this effect was concentrated in the first quarter of the year when seasonally large income tax payments increased substantially the Treasury balances at the Reserve Banks and these funds were used largely for retirement of securities held by the Reserve Banks.

In addition to the loss of reserve funds which banks sustained because of Treasury operations, member banks were required to hold a larger volume of reserves as a result of actions taken by the Board of Governors to raise reserve requirements. Effective in February and again in June, reserve requirements of member banks in New York and Chicago were increased by 2 percentage points on net demand deposits, and each of these actions increased required reserves by almost 500 million dollars. During September, largely in accordance with additional authority granted to the Board in August at the special session of Congress, reserve requirements were raised at all classes of member banks by 2 percentage points on net demand deposits and 1.5 percentage points on time deposits. As a consequence, required reserves were increased by about 2 billion dollars.

MAJOR FACTORS AFFECTING MEMBER BANK RESERVES
[In billions of dollars]

Factor	1948					1947
	Fourth quarter	Third quarter	Second quarter	First quarter	Total	
	(Sign indicates effect on bank reserves)					
Gold inflow	+0.4	+0.3	+0.4	+0.4	+1.5	+2.9
Currency returned from circulation	−0.1	−0.2	−0.1	+1.1	+0.6	+0.1
Reserve Bank market purchases of Government securities, net	+0.3	+3.2	+0.8	+2.0	+6.3	+2.5
Retirement of securities held by Reserve Banks	−0.4	−1.1	−0.3	−3.7	−5.5	−3.2
Treasury deposits at the Reserve Banks	+0.5	+0.3	(1)	−1.1	−0.3	−0.5
Nonmember deposits at Reserve Banks	−0.3	(1)	+0.1	−0.1	−0.3	−0.1
Other factors, net	+0.1	+0.1	−0.1	+0.1	+0.3	+0.1
Change in member bank reserve balances, total	**+0.5**	**+2.6**	**+0.8**	**−1.3**	**+2.6**	**+1.8**
Change due to deposit changes	+0.3	+0.3	+0.2	−0.9	−0.1	+0.8
Change due to Board action increasing requirements	....	+2.0	+0.5	+0.5	+3.0	....
Excess reserves	+0.2	+0.3	+0.1	−0.8	−0.3	+0.9

[1] Less than 50 million dollars.

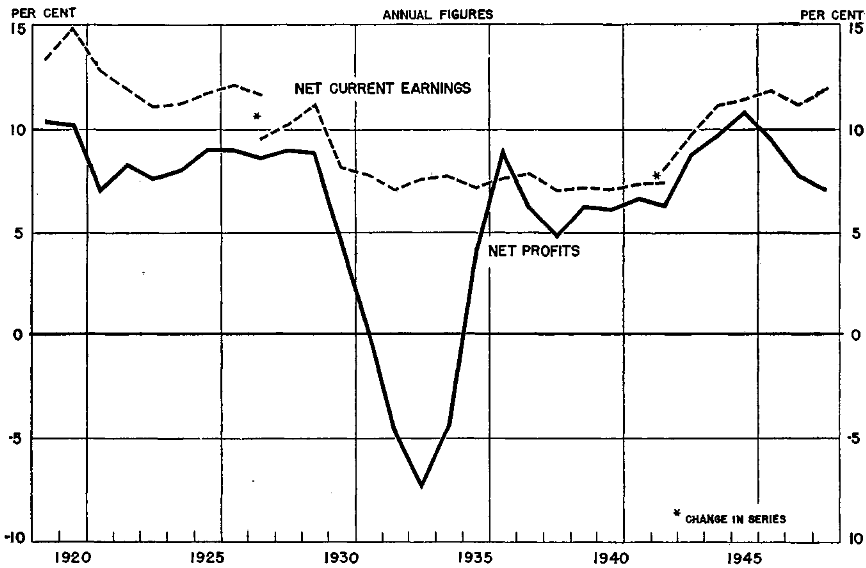
Banks were supplied with reserves in 1948 as a result of a further gold inflow of 1.5 billion dollars. This gold was received in part settlement of the country's large excess of exports over imports. A return flow of currency from circulation of 600 million dollars also added to the reserve funds available to banks. The additional reserves needed were supplied through Federal Reserve purchases of Government securities sold for the most part by commercial banks. Over the full year 1948 these purchases amounted to a net of 6.3 billion dollars.

Banks continued throughout the year to increase their loans, thus creating additional deposits and adding to reserve requirements. During the last nine months of the year, member bank reserve requirements increased by about 800 million dollars as a result of growth in deposits. Had reserve requirements not been raised by Board action, member banks could have expanded credit without selling any securities during this period.

Bank earnings and earning assets. Member bank net current earnings before income taxes were larger in 1948 than in any previous year. They amounted to 1,033 million dollars, an increase of 104 million or 11 per cent over the amount reported in 1947. Increased earnings on loans more than offset decreased earnings on United States Government securities and increased expenses. The ratio of net current earnings before income taxes to total capital accounts increased to 12 per cent, the highest level since the 1920's. The ratio of net current earnings before income taxes to total assets rose from 0.73 per cent in 1947 to 0.79 per cent in 1948.

EARNINGS RATIOS OF MEMBER BANKS

PERCENTAGES OF CAPITAL ACCOUNTS



NOTE: Net current earnings are total earnings from current operations less current operating expenses. Net profits are net current earnings plus recoveries, profits on securities, etc., less losses and charge-offs and taxes on net income. Capital accounts consist of all forms of capital, including capital notes and debentures, surplus, undivided profits, reserves for contingencies, and other miscellaneous capital accounts. Prior to 1927 profits on securities were included in current earnings; beginning in 1942 taxes on net income were excluded, while recurring depreciation was included, as a current operating expense deduction from earnings.

Member bank net profits after taxes (and after adjustments for losses, recoveries, profits on securities, and transfers to and from valuation reserves) decreased 32 million dollars and amounted to 621 million for the year. The decline in net profits, in contrast to the increase in net current earnings, reflects principally an increase in transfers to establish reserves for losses on loans under the reserve method of accounting for bad debts as authorized by the Bureau of Internal Revenue in December 1947. Net profits were 7.2 per cent of total capital accounts and, as is shown in the chart on page 23, the ratio of net profits to total capital accounts continued its downward trend from the peak of nearly 11 per cent reached in 1945. The lower ratio in 1948 was due in part to increases in capital accounts.

Earning assets of member banks amounted to about 96 billion dollars at the close of 1948, a decrease of over 2 billion during the year. A decline of nearly 6 billion dollars in holdings of United States Government securities during the year was partly offset by an increase of more than 3 billion in loans. These changes were somewhat similar to those in 1947 but, as is shown in the table, the increase in loans was less than in the previous year, and the decrease in Government securities somewhat more.

MEMBER BANK LOANS AND INVESTMENTS
[In billions of dollars]

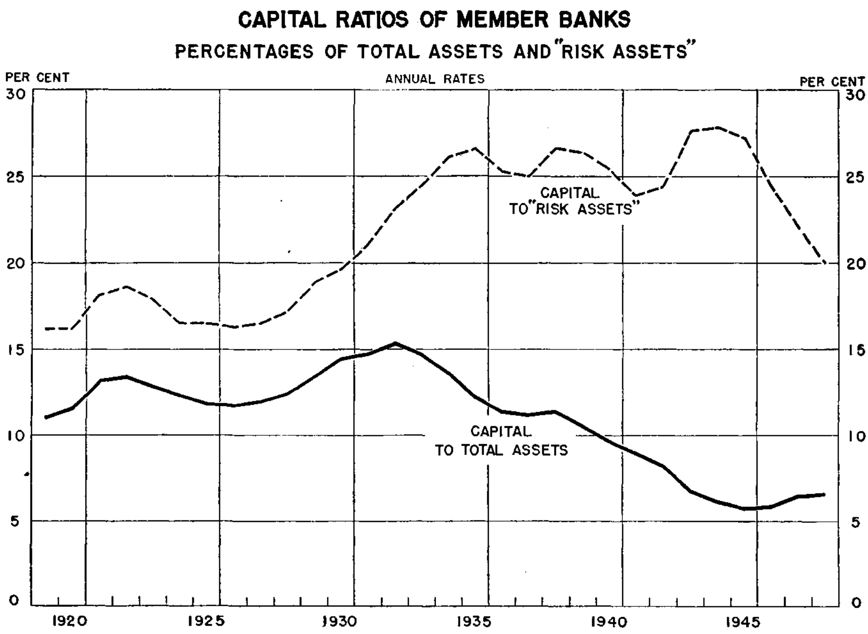
Item	Outstanding Dec. 31, 1948	Change during year	
		1948	1947
Loans and investments, total	**95.6**	**−2.2**	**+1.5**
Loans, total	**[1]36.1**	**+3.4**	**+5.9**
Commercial and industrial loans	17.6	+0.6	+3.8
Agricultural loans	1.8	+0.7	+0.2
Loans for purchasing or carrying securities	2.2	+0.3	−1.1
Real-estate loans	8.2	+1.1	+1.8
Consumer loans	5.6	+0.9	+1.4
All other, including loans to banks	1.0	....	−0.1
U. S. Government securities, total	**52.2**	**−5.8**	**−5.1**
Bills, certificates, and notes	13.4	+0.8	−4.2
Bonds	38.8	−6.6	−0.9
State and local government securities	**4.5**	**+0.3**	**+0.7**
Other securities	**2.9**	**−0.2**	....

[1] This loan total is a net figure, comparable with other totals in table and with loan totals for previous years. Individual loan items are gross figures (i.e., before deduction of valuation reserves). They do not add to total and are not entirely comparable with net figures shown in previous reports. Before computing annual changes for 1948, individual loan items for the end of 1947 were adjusted to a gross basis.

Total holdings of Treasury bills, certificates, and notes increased for the first time since 1945, and Government bond holdings declined by 6.6 billion dollars in contrast to a decline of less than 1 billion in the previous year. These shifts resulted from higher yields available on short-term securities, the retirement of bonds maturing or called for redemption, and perhaps some uncertainty as to whether the current support level of Government bond prices would be continued. The average yield to member banks on their Government security holdings increased slightly from 1.53 per cent in 1947 to 1.56 in 1948. The average yield on loans also continued to increase, from 3.56 to 3.83 per cent.

Capital accounts. Capital accounts of member banks increased by 337 million dollars in 1948, as compared with an increase of 369 million in the previous year. Retention of profits accounted for most of the increase. Sales of additional common stock increased slightly and retirements of preferred stocks and capital notes declined slightly from 1947, resulting in a capital increase of 11 million dollars from these transactions, as compared with a net decline of 6 million in 1947. Dividend payments amounted to 294 million dollars in 1948, an increase of 13 million over the previous year. They represented 3.4 per cent of total capital accounts at the year end and 47 per cent of net profits.

The ratio of average total capital accounts to average total assets increased for the third successive year, as is shown in the accompanying chart, and amounted to 6.6 per cent in 1948. In contrast, the ratio of average total

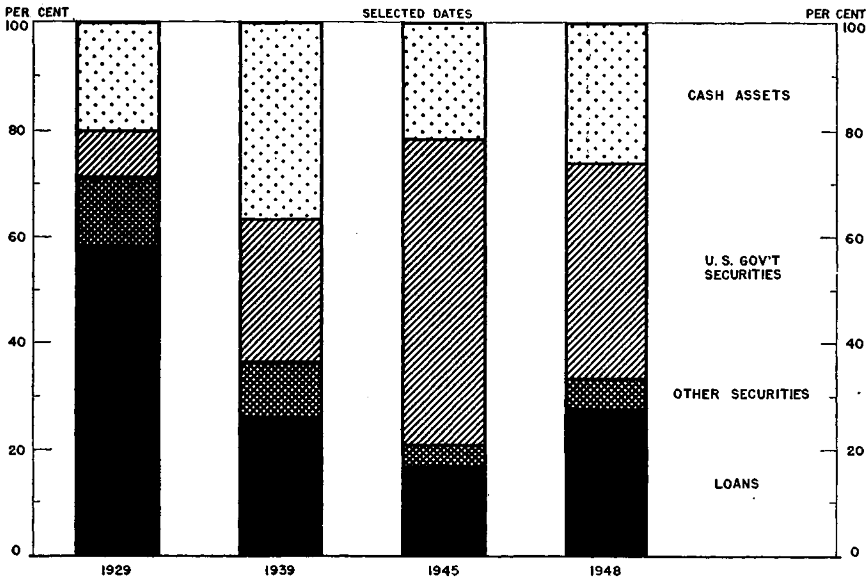


NOTE: "Risk assets" represent total assets other than cash assets and U. S. Government securities. Capital and asset figures are based on averages of June and December call date figures 1919-40 and of three or four call date figures thereafter.

capital accounts to average risk assets, defined to include all assets other than cash assets and United States Government securities, continued to decline from the peak reached in 1944 and amounted to only 20 per cent in 1948, the lowest ratio since 1930. The decline has resulted from a far greater relative growth in so-called risk assets than in total capital accounts. In 1947 and 1948 there were increases of nearly 7 billion and 4 billion dollars, respectively, in risk assets.

Changes in the distribution of member banks assets by broad groups during the past two decades are shown in the accompanying chart. It will be noted that loans and securities other than those of the United States Government, which comprised three-fourths of total assets in 1929, were only a fifth of the total in 1945 and, notwithstanding the subsequent increase in loans and decline in holdings of Government securities, were still only about a third of the total at the end of 1948.

CHANGES IN MEMBER BANK ASSETS



NONBANK SOURCES OF INVESTMENT FUNDS

A lower rate of expansion of private loans and investments by commercial banks in 1948 was accompanied by a substantial increase in lending and investing by other groups in the economy. Financial institutions other than commercial banks—especially the savings institutions—increased their investments in business securities and mortgages. Individuals purchased a considerably larger volume of corporate and State and local government securities last year than in the previous year. Finally, business enterprises invested slightly more of their own funds in 1948 than in 1947.

Savings institutions as a group extended a substantially greater volume of credit to private borrowers in 1948 than they did in previous years. This credit was extended largely to provide business corporations with additional funds for carrying out capital expansion programs and to finance the purchase of homes and other construction. The amount of new savings flowing to such institutions was slightly smaller in 1948 than in other recent years.

The increase in their lending was financed by the liquidation of a large volume of United States Government securities.

During 1948 the life insurance companies are estimated to have reduced their portfolios of United States Government securities by 3.3 billion dollars. The proceeds of this liquidation were added to 3.6 billion dollars of receipts from other sources, mainly new individual savings, to provide nearly 7 billion of funds for increased private investment. This increase was approximately 35 per cent larger than the increase in 1947. The principal increases in life insurance investments in 1948 occurred in corporate securities—4.2 billion dollars—and in mortgages—2.2 billion.

At mutual savings banks, additional deposits and retained earnings amounting to 0.7 billion dollars, together with a reduction of 0.5 billion in holdings of United States Government securities, provided 1.2 billion for new investment in 1948, as compared with 1.0 billion in 1947. They invested most of these funds in business securities and real-estate mortgages.

Savings and loan associations, in contrast to life insurance companies and mutual savings banks, invested slightly less in 1948 than in 1947—1.8 billion dollars as compared with 1.9 billion. Funds came largely from new savings. A small decline in holdings of Government securities was partly offset by an increase in cash.

The continued large volume of internal funds available to business corporations in 1948—principally from retained profits, amounts set aside for depreciation allowances, and a small reduction in liquid asset holdings—enabled them in the aggregate to finance their record expenditures with relative ease. Such funds amounted to 16.3 billion dollars in 1948 and 15.5 billion in 1947. The total of internal funds was a slightly larger proportion of total business funds from all sources, external as well as internal, in 1948 than in the preceding year. The large volume of internal funds available to businesses in 1948 was largely invested in plant, equipment, inventories, and customer credit.

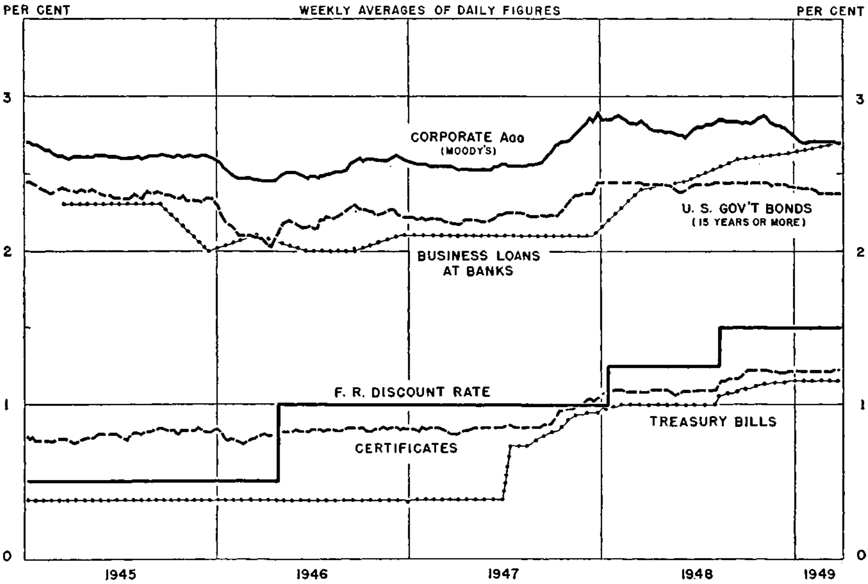
During 1948 individuals and unincorporated businesses reduced their holdings of currency and demand deposits by approximately 1 billion dollars. At the same time individuals increased their holdings of corporate and State and local government securities by almost 3 billion dollars, which was slightly more than double the increase in 1947. Individuals also added further to their holdings of United States Government securities.

CHANGES IN STRUCTURE OF INTEREST RATES

Short-term money rates rose further in 1948, chiefly as a result of official policies permitting a rise in rates on short-term Government securities while maintaining yields on long-term Treasury bonds. Yields on corporate and municipal bonds fluctuated during the year but were slightly lower at the end than at the beginning. Stock yields rose to quite high levels for prosperity conditions.

In the first two months of 1948, rates on short-term Government securities continued to rise as they had during the last half of 1947 and then changed little until August. One-year certificates were offered at 1⅛ per cent and rates on Treasury bills were just under 1 per cent. In August, the Treasury announced 1⅜ per cent one and one-half year notes in exchange for notes maturing September 15, and 1¼ per cent one-year certificates for certificates and notes maturing October 1. Rates on Treasury bills rose to about 1⅛ per cent by the end of the year. Federal Reserve Bank discount rates, which had been raised from 1 per cent to 1¼ per cent in January, were increased again in mid-August to 1½ per cent.

MONEY RATES



NOTE: For Treasury bills, rate is average discount on new issue during week. Federal Reserve discount rate is for the Federal Reserve Bank of New York. Rate on business loans at banks is average for loans made at banks in 19 selected cities in the first 15 days of March, June, September, and December.

Some increases also occurred in the interest rates charged by banks on loans to their customers. Average rates for all types of short-term business loans made by banks in 19 selected money centers rose from 2.1 per cent in December 1947 to 2.6 per cent in December 1948, as is shown in the accompanying chart. The rise in rates applied to business loans of all sizes.

Bond yields generally, which had advanced somewhat during the last four months of 1947, showed little further change in 1948. The average yield on high-grade corporate bonds, for example, was 2.8 per cent in December 1948 compared with 2.9 per cent in December 1947. A slight decline in yields in the first half of the year was followed by a rise in the summer and another slight decline in the closing weeks of the year. Yields on other grades of corporate bonds and on municipal bonds fluctuated more during the year than did those on high-grade corporate issues and showed small, mixed changes for the year as a whole.

INCREASED SUPPLIES AND MORE SELECTIVE PRICE MOVEMENTS

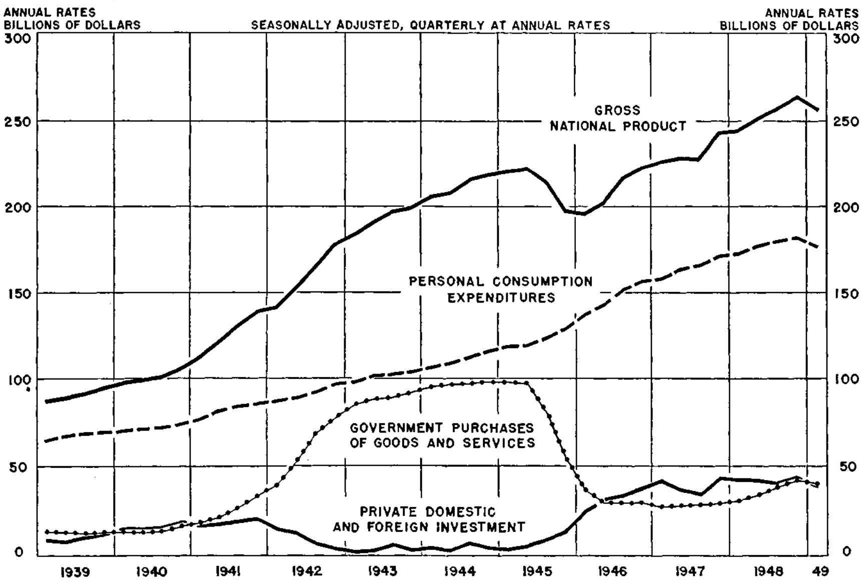
During 1948 production in most areas of the world increased further and more goods and services were made available to consumers and producers than at any other time since the end of the war. As a consequence, many of the shortages which had persisted during 1946 and 1947 were eliminated, and price developments became more selective—by country, by product, and by stage of production and distribution. The increase in supplies resulted largely from further progress toward orderly conditions of production and trade in many parts of the world, further development by the United States of a broad program of aid to Western Europe, expansion in plant capacity and material supplies, and more favorable growing conditions for crops in important areas. Demand, while uneven and not as much in excess of supply as before, on the whole was still strong, providing the incentive required for heavy production in this period.

In the United States, where production before 1948 had already risen to levels very close to capacity, further increases were generally moderate. Crop production was considerably larger than in 1947, and there were substantial increases in construction activity and electric power production. Output of manufactures and minerals expanded only moderately, owing in some instances to supply limitations but in others to a leveling off or a reduction in demand. As before, more goods were shipped abroad than were received but the difference, which had been very great in 1947, was considerably reduced in 1948 because exports declined and imports increased. Government purchases for stockpiling and other military purposes expanded, but altogether the share of domestic production available for civilian use was somewhat larger than in 1947 and actual supplies available to consumers and businesses reached new high levels. Some of the increased product available for civilian use went into business inventories, facilitating future production, speeding the delivery of goods to customers, and weakening the bargaining position of sellers.

As a consequence of this and of various other developments, such as the replenishment or building up of supplies of goods in the hands of domestic consumers and a reduction in export demand, inflationary pressures eased somewhat. The general level of wholesale commodity prices, which had advanced rapidly in 1947, declined early in 1948. Then it rose to a new peak in the third quarter, with sharp advances in meats, livestock, and metals and metal products, and little change for most other commodities. In the last quarter of 1948, prices declined to about the level prevailing at the end of 1947, and in early 1949 they declined more sharply. Wage rates advanced further in 1948, particularly during the late spring and summer months. In capital markets, farm land values showed some further rise until the latter part of the year, while real property values in urban areas continued close to earlier high levels and security prices showed little change.

Reflecting the larger volume of goods sold as well as the higher level of prices prevailing, total expenditures for goods and services during the year amounted to 255 billion dollars, as compared with 232 billion in 1947, an increase of 10 per cent. The rise from the fourth quarter of 1947 to the fourth quarter of 1948 was almost as large as this. The course of expenditures in 1948 is shown in the chart for the total and for broad types of outlays. Subsequently, in the first quarter of 1949, expenditures showed the first significant decline since the period immediately following the end of the war.

GROSS NATIONAL PRODUCT



NOTE: U. S. Department of Commerce data.

From the fourth quarter of 1947 to the fourth quarter of 1948, outlays by governments for currently produced goods and services rose by 12.5 billion dollars. Federal outlays showed a marked increase, chiefly for military purposes and foreign aid in the form of grants, and there was further substantial growth in outlays by State and local governments, both for current operations and for construction projects, particularly schools and highways.

The slight reduction indicated for private domestic and foreign investment together reflected a sharp decline in net foreign investment which more than offset a 7.5 billion dollar increase in domestic investment. The sharp decline in foreign investment was due chiefly to marked declines in net exports of goods and in the share of Federal aid to other countries which took the form of loans rather than grants. The rise in domestic investment reflected mainly a further rise in outlays for producers' equipment and an increase in inventory accumulation. Part of the increase in inventory accumulation was accounted for by a shift in the situation on farms where, because of very large crops, stocks were being increased rather than depleted.

Personal consumption expenditures in the fourth quarter of 1948 were at an annual rate about 10 billion dollars higher than in the final quarter of 1947. Meanwhile personal disposable income increased by about 18.5 billion and consumption expenditures declined as a proportion of personal disposable income. Expenditures for new houses, regarded as investment rather than consumption outlays, were at about the same level at the end of 1948 as a year earlier. There was a substantial increase in net current personal saving, which includes expenditures for new houses as well as accumulations of securities and liquid assets minus increases in debt. Consumer indebtedness for housing and other purposes continued to increase, although at a slackened rate toward the end of the year.

PERSONAL INCOME AND EXPENDITURES

[In billions of dollars]

Item	Year		Fourth quarter[1]	
	1948	1947	1948	1947
Personal income	213.6	195.2	219.6	203.1
Disposable income[2]	192.6	173.6	199.4	180.9
Consumption expenditures	177.7	164.8	181.0	171.1
Durable goods	*22.7*	*21.0*	*22.9*	*22.1*
Nondurable goods	*103.6*	*96.5*	*105.1*	*100.2*
Services	*51.4*	*47.3*	*53.0*	*48.8*
Personal saving	14.9	8.8	18.4	9.7

[1] Seasonally adjusted quarterly totals at annual rates.
[2] Disposable income is personal income less income taxes.
SOURCE: U. S. Department of Commerce.

More selective price movements. Price movements, which had been very generally upward most of the time from the end of the war through 1947, became much more selective in 1948, especially in commodity markets but also to some extent in markets for real property. Upward adjustment of wages was also somewhat more selective. The general level of wholesale prices, which had risen 16 per cent the previous year, showed no net change in 1948 and consumer prices rose only 3 per cent, as compared with 9 per cent in 1947. In wholesale markets, prices of some products, notably metals and many of their manufactures, rose further, as demand continued in excess of supply during most of the year; at the other extreme, prices of crops declined sharply, to Federal price support levels, under the impact of harvests greatly in excess of current use. Consumer prices were higher at the year-end than at the beginning of the year for most types of goods and services but were somewhat lower for foods. Comparative data are given in the accompanying table.

CHANGES IN PRICES

Group	Percentage increase or decrease		
	Dec. 1947 to Dec. 1948	Dec. 1946 to Dec. 1947	1935-39 to Dec. 1948
Basic commodity prices (28 items)	−15	+17	+153
General wholesale index:			
Total	−1	+16	+101
Farm products	−10	+17	+133
Foods	−5	+11	+115
Other commodities	+5	+17	+88
Textile products	−1	+10	+107
Building materials	+6	+21	+126
Fuel and light	+10	+30	+82
Metals and products	+15	+12	+89
Consumers' prices	+3	+9	+71
Food	−1	+11	+105
Apparel	+5	+8	+100
Rent	+4	+6	+20

NOTE.—Based on Bureau of Labor Statistics data.

While net changes in prices over the whole year were small, changes within the year were large. In the first few weeks of 1948, the rapid rise in prices which had characterized the latter part of 1947 came to an end and in February prices of numerous products, especially grains and livestock, dropped sharply. There were declines in retail as well as wholesale markets for some products, particularly meats. The reaction in prices, however, did not become general.

During the spring and summer months, although crop prospects improved and prices of some crops remained near Federal support levels, prices in many markets advanced considerably, bringing the general average to a new high. Cotton prices rose from 32 cents a pound in February to 37 cents in May and June. During the summer, metal prices rose more rapidly than at any time since the end of 1946, when Federal price controls were removed; livestock and meat prices advanced to new peaks, despite the prospect of greatly increased feed supplies; and prices of fuels rose somewhat further. This strengthening did not extend to as many markets as had earlier advances but it was nevertheless important. Beginning in May it was accompanied by further wage advances which, though not as large as those in 1946 and 1947, were substantial.

The whole upward movement in prices and wages after the reaction in prices early in the year reflected largely the widespread strength of existing demand, although for some commodities, such as nonferrous metals, interruptions to supply were also important. The demand situation was strong at this time, partly because many demands deferred from the war period had not been fully met, an expanded defense program and a program of economic aid to Western Europe were being inaugurated, and Federal taxes on personal incomes were being reduced. To some extent the rise in metal prices represented an adjustment of prices to market conditions which had prevailed for some time rather than a response to further expansion in demand.

The high point of this advance in commodity prices as a whole was reached in August, and during the remaining months of the year there were declines in both wholesale and retail markets. Sharp reductions in prices of livestock and meats, marked continuing declines in textiles, and reductions in some types of lumber were offset only in part by further increases in metals and metal products. In markets for some metal products such as household appliances, moreover, sales declined toward the end of the year, production schedules were revised downward from earlier exceptional peak levels, and later, in the early part of 1949, prices were reduced somewhat. Prices in used car markets declined rather more than seasonally. Supplies of fuel, which had been very short in the winter of 1947-48, increased and inventories accumulated, setting the stage for some decline in production and prices of fuel in the early part of 1949.

In general, the easing of inflationary pressures in the latter part of the year was in marked contrast to the resurgence of upward pressures in the latter part of 1947, but activity and employment continued at a high level, incomes reached a new peak, and unemployment remained at a very low level. Later, in the first quarter of 1949, further easing in the general situation was reflected in further price reductions, declines in production and employment, and an increase in unemployment.

Production close to capacity and demand. In broad terms, production in 1948 continued close to capacity and, for a variety of reasons, supplies came to approximate demands in most lines and to exceed demands in a number of other lines. As the year began, much progress had already been made in replenishing inventories at all stages of production, distribution, and consumption and in modernizing and expanding the country's industrial plant. During 1948 output was larger than in 1947 and the volume of goods exported was reduced from earlier peak levels. Domestic consumer demand continued strong until the latter part of the year when there was some weakening in a number of markets. At the year-end public programs called for further increases in outlays and private investment programs were still large in many lines, particularly the public utilities, but in some other lines, such as residential building, less new work was being undertaken.

Production was larger in 1948 than in 1947, partly because capacity and supplies in some lines had been increased and partly because weather conditions were much more favorable to crops. Construction activity rose further in 1948 as supplies of materials and labor expanded and in some fields, such as residential building, supply came to equal or exceed demand at existing high price levels, tending to ease the market for both old and new houses and to encourage caution on the part of potential home buyers, financing agencies, and builders. Electric power output expanded further by a large amount, but capacity and output at the end of the year were still inadequate to meet expanding demand in some areas, particularly the Pacific Northwest.

In industry—at factories and mines—output for the year, at 192 per cent of the 1935-39 average, was moderately higher than the 1947 level of 187. It showed little change during the course of the year, however, as further advances in output of some products, notably steel, automobiles, and petroleum, were offset by declines in output of some other products such as cotton textiles, shoes, and coal. In many industries, such as the machinery, chemicals, and food processing industries, output continued at earlier high levels.

In transportation there was not much change in the total volume of traffic from 1947 to 1948, partly because much of the increased output of agricultural products was held on farms. There was some further shift of traffic from the railroads to other forms of transportation; toward the end of the year carloadings fell below the levels prevailing late in 1947. Substantial current output of freight cars eased the shortage of railroad equipment, and demand for new automobile trucks was fairly well maintained although the number of trucks on the road reached a new peak.

As long as production in the economy was generally close to capacity but still short of demand, and as long as prices consequently were increasing at a rapid rate, one important question was how much production might be short of demand. Another was how long it would take to increase production enough to make up the difference and this posed the question of the course of demand as well as of supply. Would demand increase further, especially if military or related demands expanded? On the other hand, would it perhaps decline, as some of the more urgent deferred demands were met?

By the beginning of 1949, as production seemed to be catching up with or exceeding demand in an increasing number of lines, and as price declines became more numerous, questions concerning the course of prices and employment in the immediate future came more into the foreground. Earlier weaknesses in some prices during 1947 and 1948 had been followed by sharp advances and the extent of future demands, especially in connection with international developments, was not known. It was evident also that the financial position of consumers and producers was still relatively strong and that, as in other postwar years of generally rising incomes, sellers having excess stocks had often been able to dispose of them by reducing prices only moderately.

But, as supplies increased throughout the economy, in the hands of consumers as well as producers and distributors, demands were becoming less urgent. Consumers were saving more of their incomes and there were important questions concerning the course of consumer buying and the utilization of the increased personal savings together with the exceedingly large volume of undistributed business profits available for investment purposes. In the field of private investment the general tendency was toward a lower rate of expenditure, while Government outlays for goods and services were rising somewhat.

On the whole, the prospective course of prices, production, employment, incomes, and expenditures appeared to be downward in the early part of 1949 but economic activity was still not far below the peak levels reached during 1948.

INTERNATIONAL TRADE AND FINANCE

In 1948 there was a sharp reduction in the United States export surplus from the record peacetime level of 1947. As has been indicated earlier, this development was the combined result of a substantial decline in exports and a marked increase in imports. Exports of goods and receipts for services performed for foreigners amounted to 16.8 billion dollars in 1948, a decline of 2.9 billion from the preceding year. At the same time, imports and payments to foreigners for services amounted to 10.5 billion dollars, a figure almost one-fourth larger than in 1947. While still large, the export surplus, amounting to 6.3 billion dollars, was the smallest since 1942, and was 44 per cent below the level of 1947.

In the financing of the export surplus, the greatest change from the pattern of 1947 occurred with respect to the use of foreign gold and dollar assets. The net liquidation of such assets during the year was less than 1 billion dollars, as compared with 4.5 billion in 1947. There was also a decrease in United States Government aid, which, notwithstanding inauguration of the European Recovery Program, declined from 5.7 billion dollars in 1947 to 4.7 billion in 1948. Partly as a result of continued political uncertainty abroad, private investment and lending by international institutions continued at relatively low levels.

While the previous depletion of foreign gold and dollar resources and the decrease in United States aid were in part responsible for the reduction in the export surplus, this decline should also be regarded as evidence of a gradual return to a more balanced situation for the world as a whole. In large measure, the export surplus of recent years has reflected the contribution of the United States to postwar reconstruction. It was, therefore, to be expected that, as reconstruction proceeded, the abnormal dependence of foreign countries on United States production and financial assistance would diminish and that the United States would purchase an increasing amount of goods and services from abroad.

The movement toward international balance reflected in the United States balance of payments in 1948 was by no means uniform for all countries. The United Kingdom, largely because of a persistent sellers' market abroad and continued austerity at home, was able to reduce its over-all external deficit by more than four-fifths and its gold and dollar deficit by more than one-half. Canada and Italy also substantially improved their positions and, largely as a result of increased exports, were able to increase their dollar holdings during the year. Other countries, such as France, did not succeed in materially reducing their balance-of-payments gap, and Germany and Japan continued to need large amounts of outside aid. Finally, further deterioration in the international economic positions of such countries as South Africa, Argentina, and Mexico led to losses of reserves, tighter import controls, or currency depreciation.

The long-run policy of the United States continued to be directed toward the gradual elimination of trade restrictions as an important step in bringing about a high level of mutually beneficial international trade. An important objective of the European Recovery Program has been to prepare the European nations to participate in freer multilateral trade.

Exports and imports of the United States. Recorded exports of merchandise in 1948 amounted to 12.6 billion dollars, as compared with 15.3 billion in 1947. Owing to a 7 per cent increase in the average level of prices of export commodities, the decline in physical volume of exports was even greater than indicated by the decline in dollar amount. Receipts from services and investments, amounting to 3.4 billion dollars, were slightly below the 1947 level.

Recorded United States imports of merchandise amounted to 7.1 billion dollars in 1948, an increase of 1.3 billion from the level of 1947. This increase was accounted for by an 11 per cent increase in the import price level and by a roughly similar increase in physical volume. The growth in imports was shared by all major types of commodities. Payments to foreign countries for services and on investments increased from 2.4 billion dollars in 1947 to 2.8 billion in 1948. Imports of goods and services were equal to 4.7 per cent of the national income of the United States in 1948, as compared with 4.2 per cent in 1947. In the years immediately preceding the war, the corresponding percentage was about 6 per cent.

Until recent years, an export balance in United States merchandise trade with Europe, North America, and Africa was usually offset in part by an import balance with Asia and with South America. Since the war, however, United States exports have exceeded imports in every major area. This continued to be true in 1948, but to a less impressive extent. In the case of each major foreign area, the ratio of United States imports to United States exports was considerably higher in 1948 than in 1947. Recorded exports and imports of merchandise, by areas, are shown in the accompanying table.

UNITED STATES MERCHANDISE TRADE

[Dollar items in millions]

Area	1948 trade			Imports as a percentage of exports		
	Exports	Imports	Net exports	1948	1947	1935–39 annual average
Recorded trade, total	**$12,619**	**$7,070**	**$5,549**	**56.0**	**37.4**	**82.4**
Africa	785	407	378	51.8	39.8	53.1
Asia	2,094	1,332	762	63.6	44.9	145.7
Europe	4,286	1,092	3,194	25.5	14.4	55.3
North America	3,393	2,538	855	74.8	56.0	81.4
Oceania	153	164	−11	107.2	48.6	40.8
South America	1.908	1,537	371	80.6	52.5	118.8
Unrecorded trade[1]	**779**	**641**	**138**	....	....	....
Total	**$13,398**	**$7,711**	**$5,687**	**57.6**	**37.8**	**84.9**

[1] Consists mainly of certain U. S. Government transactions. On the export side, sales of Government surplus property to foreigners, and certain categories of civilian supplies distributed by the armed forces in occupied areas, accounted for the bulk of such transactions in 1947 and 1948.

Means of financing export surplus. About three-fourths of the total export surplus of the United States in 1948 was financed by gifts and loans from the United States Government. The dollars to cover the remaining net exports were derived, as shown by the table on page 38, from private United States investments and gifts, from loans by the International Bank and the International Monetary Fund, and from the sale of gold and other foreign-owned assets to the United States. In contrast with 1947, these sales were of relatively minor importance to the financing of the export surplus in 1948.

In 1948, the United States Government extended financial assistance to foreign countries amounting to 4.7 billion dollars, or 17 per cent less than in 1947. The amount of donations, however, was more than twice as large as in 1947, since the great bulk of Government assistance in 1948 took the form of gifts rather than loans. European countries received more than three-fourths of the aid extended by the United States Government in 1948, largely as part of the European Recovery Program.

Private gifts and investments continued to finance a part of the net exports from the United States. The net amount of charitable contributions and personal remittances in 1948 was about 600 million dollars. The net outflow of private capital, amounting to about 900 million dollars, consisted mainly of advances by parent companies in this country to their subsidiaries abroad.

As previously indicated, various countries found it necessary to draw on their holdings of gold and other liquid assets in the United States. Net sales of gold to the United States by foreign countries amounted to 1.5 billion dollars during the year. In considerable part, however, these sales were offset by an increase of 1 billion dollars in foreign banking funds held in the United States. Part of the gold sales represented new foreign production of gold, which remained at the 1947 level of about 700 million dollars (not including Soviet production). Total foreign gold and dollar holdings, which had been depleted considerably in 1947, thus remained approximately constant in 1948.

FOREIGN TRADE OF THE UNITED STATES AND MEANS OF FINANCING[1]
[In billions of dollars]

	1948	1947
United States exports, total	**16.8**	**19.7**
Goods	13.4	16.1
Services	3.4	3.7
United States imports, total	**10.5**	**8.5**
Goods	7.7	6.1
Services	2.8	2.4
Net purchases from United States by foreign countries	**6.3**	**11.3**
Sources of financing utilized by foreign countries, total	**7.5**	**12.3**
United States Government, net total	**4.7**	**5.7**
Credits	0.9	3.9
Donations	3.8	1.8
United States—private, net total	**1.5**	**1.3**
Foreign investment (long- and short-term)	0.9	0.7
Donations	0.6	0.6
International institutions, net total	**0.4**	**0.8**
Dollars disbursed by International Bank	0.2	0.3
Dollars drawn from International Monetary Fund	0.2	0.5
Foreign countries' own capital assets, net total	**0.9**	**4.5**
Sales of gold to United States	1.5	2.8
Reduction of banking funds in United States	[2] −1.0	1.2
Liquidation of other assets in United States	0.3	0.5
Errors and omissions	**−1.1**	**−1.0**

[1] This table is derived largely from U. S. balance-of-payments data compiled by the Department of Commerce. Gold and dollar transactions between the United States and the International Monetary Fund and the International Bank are omitted while gold and dollar financing provided by the Fund and the Bank are included. ECA disbursements that are ultimately to be placed on a loan basis are treated as credits. Details may not add to totals because of rounding.
[2] Increase.

CHANGES IN BANKING STRUCTURE

Number of banking offices. There was a net increase of 189 banking offices in the United States in 1948. This was the fifth consecutive annual increase and followed somewhat larger increases of 207 in 1947 and 225 in 1946. The number of newly organized banks and branches was 242, as compared with 271 in 1947 and 301 in 1946. The banking offices that went out of existence in 1948 totaled 53, a smaller number than in either of the two preceding years. At the end of 1948 there were 19,164 banking offices (14,703 banks and 4,461 branches and additional offices). There were also 70 banking facilities at military reservations, excluded from the foregoing figures, a decrease of one during the year; at the end of the war, there were about 350 of these offices.

The number of banks (head offices) declined in 1948 for the first time since 1944. The net decline of 11 compares with net increases of 14 in 1947, 32 in 1946, and 18 in 1945. The number of new banks opened for business was 80, a decline from the corresponding figures of 111 in 1947 and 144 in 1946. These declines followed increases beginning in 1943 and reaching a peak in 1946. Twenty of the 80 banks opening for business were member banks, 41 were insured nonmember banks, and 19 were noninsured banks. Of the 91 banks discontinued through consolidation, liquidation, etc., 56 became branches. The number of banks in operation at the end of 1948 was 14,703 (14,171 commercial banks and 532 mutual savings banks).

The number of branches and additional offices, exclusive of offices at military reservations, increased by a net of 200 during the year. This increase in 1948, although only slightly larger than in 1947 and 1946, was the largest since 1934. The number of such offices has increased in every year since 1933 except 1942, when it remained unchanged.

Approximately 40 per cent of the new banks opened for business in the past four years have been in Georgia, Illinois, and Texas, where branch banking is prohibited. About the same percentage of the new branches have been in California, Massachusetts, Michigan, and New York, while the new banks opened in these four States have amounted to only 6 per cent of the total.

Changes in Federal Reserve membership. Membership in the Federal Reserve System decreased for the first time since 1938. The loss of 5 banks in 1948 compares with net gains of 23 in 1947 and 16 in 1946. The number of national banks decreased by a net of 14 and the number of State member banks increased by a net of 9. Admissions to membership were more than offset by consolidations, etc., in which 37 banks became branches. Of the 49 banks admitted to membership, 17 were national banks and 32 were State banks; of the latter, 5 were newly organized and 27 were already in operation. All but one of the 27 had previously been admitted to membership in the Federal Deposit Insurance Corporation and their total deposits amounted to about 83 million dollars. A survey made by the Reserve Banks as of December 31 showed that nearly one-third of the nonmember commercial banks were ineligible for membership in the Federal Reserve System on the basis of statutory capital requirements.

The 6,918 member banks in operation at the end of 1948 accounted for 49 per cent of the number and 85 per cent of the deposits of all commercial banks in the country. The State member banks accounted for 21 per cent of the number and 65 per cent of the deposits of all State commercial banks. These percentages have remained practically unchanged in recent years.

Par and nonpar banks. During 1948 there was a net increase of 24 in the number of banks on the Federal Reserve Par List and a net decrease of

30 in the number of nonpar banks.[1] These changes continued the trend of several years but the number of banks involved was somewhat smaller. During the year, 112 banks were added to the Par List, 7 were withdrawn, and 81 banks formerly on the list terminated existence. Of the latter, 72 were absorbed by other par banks and 55 of the 72 were converted into branches. There were net increases in nonpar banks in only three States.

At the end of 1948 there were 12,061 banks remitting at par and 2,011 nonpar banks. The latter represented only 14 per cent of the banks on which checks are drawn and held a very small proportion of the deposits of all commercial banks in the country. The number of nonpar branches of commercial banks, which has been decreasing slightly in recent years, was 318 at the end of the year.

In February 1949, when the last nonpar bank in one State came on the Par List, there were 5 Federal Reserve districts and 28 States and the District of Columbia in which all banks were on the Federal Reserve Par List. In each of 5 other States, the number of nonpar banks was less than 10. At the end of 1948 over 99 per cent of the banks not on the Par List were in the following 15 States: Minnesota 416, Georgia 294, Mississippi 165, Arkansas 124, North Carolina 116, Wisconsin 107, Alabama 106, Louisiana 103, South Dakota 100, Tennessee 95, North Dakota 89, South Carolina 89, Missouri 67, Florida 63, and Texas 58.

Check routing symbols. Further progress was made during 1948 in the uses of routing symbols on checks to facilitate their collection. The program was inaugurated by the American Bankers Association and the Federal Reserve System in June 1945.

Nearly all of the banks on the Federal Reserve Par List now have check routing symbols printed on some of their checks in the approved location, i.e., in the upper right-hand corner. On the basis of a survey made as of December 1, 1948, it was found that 58 per cent of all checks clearing through Federal Reserve Banks carried routing symbols in the approved location.

Designation of reserve cities. In accordance with the basis for the classification of reserve cities adopted in December 1947 by the Board of Governors and published in the 1947 Annual Report, the following changes were made in the classification of reserve cities, effective March 1, 1948: The city of National City (National Stock Yards), Illinois was classified as a reserve city, and the designations of the following cities as reserve cities were terminated: Grand Rapids, Michigan; Ogden, Utah; and Spokane, Washington.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

The year 1948 ended with a very moderate decrease in the total resources of all member banks. There were also changes in the character of assets held

[1] The Federal Reserve Par List comprises all member banks, which are required under the law to remit at par for checks forwarded to them by the Federal Reserve Banks for payment, and also such nonmember banks as have agreed to do so.

by the banks, representing in the main a continuing shift from what are usually termed riskless assets (cash assets and United States Government securities) into loans. The larger volume of risk assets commensurately increased the responsibilities of bank managements and bank supervisory authorities to detect and correct elements of weakness as they develop.

While the number and volume of assets of State member banks with problem characteristics were small in the aggregate, the fact remains that the high level of business activity in 1948, as in the past several years, tended to obscure real and potential elements of risk in loans and to increase the difficulty of their proper appraisal by bank managements and examiners. Manifestly, a diminution of business activity could affect adversely the collectibility of many loans and disclose a greater degree of deterioration than is now apparent.

Difficulty in finding and attracting capable bank personnel continued to be a problem during the year, for some of the smaller banks in particular.

The continued increase in risk assets in 1948 was not offset by proportionate increases in aggregate capital. Therefore, the need for capital became even more pronounced. While a relatively few State member banks sold additional common stock during the year, many were reluctant to take such action. In some cases this reluctance appears to spring from unwillingness of controlling interests to dilute their stockholdings through sales of new stock. In other cases lack of market appears to be the most important obstacle. In such circumstances it has been urged that caution be exercised in further expansion of risk assets and disbursement of earnings through cash dividends.

The Board continued during the year to work closely with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Executive Committee of the National Association of Supervisors of State Banks on matters of mutual interest pertaining to bank examination and supervision.

Examination of Federal Reserve Banks. The Board's Division of Examinations examined each of the twelve Federal Reserve Banks and their twenty-four branches during the year as required by law.

Examination of State member banks. State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. In order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking authorities or alternate examinations are made by agreement with State authorities. The 1948 program for the examination of State member banks was substantially completed.

A conference of the Vice Presidents in charge of bank examination and supervision at the several Federal Reserve Banks was held at the offices of the Board of Governors on February 12 and 13, 1948 to consider current supervisory problems. Representatives of the Comptroller of the Currency and the Federal Deposit Insurance Corporation participated in the conference. The annual convention of the National Association of Supervisors of State Banks, held in Louisville, Kentucky, in September, afforded another opportunity for an informal meeting of the bank supervisory officers of the Federal Reserve Banks with representatives of the Board to consider matters of current interest.

Bank holding companies. During 1948 the Board acted on applications for voting permits submitted by holding company affiliates of banks and authorized the issuance of four permits for general purposes and five permits for limited purposes.

The regular annual reports were obtained from holding company affiliates to provide information with respect to the organizations to which voting permits have been granted. In accordance with established practice, a number of holding company affiliates were examined during the year by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

Section 301 of the Banking Act of 1935 provides that the term "holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to seven organizations.

As mentioned in previous reports, the existing statutes do not provide adequate means for regulation of bank holding companies. The Board's recommendations for the strengthening of such regulation are presented earlier in this report.

Trust powers of national banks. During the year, 13 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11(k) of the Federal Reserve Act. This number includes the grant of additional powers to one bank which previously had been granted certain trust powers. Trust powers of 10 national banks were terminated by voluntary liquidation or consolidation. At the end of 1948 there were 1,788 national banks holding permits to exercise trust powers. A list of such banks, with indication of the power or powers each bank is authorized to exercise, will be supplied to those requesting it.

Foreign branches and banking corporations. The Board approved six applications made during 1948 by member banks pursuant to the provisions of Section 25 of the Federal Reserve Act for permission to establish foreign branches. During the year member banks opened eight foreign branches, several of which had been authorized by the Board prior to 1948. The new branches were distributed geographically as follows: Brazil 3, Germany 1, Japan 3, Philippines 1. Owing to disturbed conditions, the operations of one foreign branch were in temporary suspension at the end of the year under the provisions of the Board's Regulation M. The types of banking operations conducted by branches in Germany and Japan are restricted by the terms of the licenses issued by the military occupation authorities.

At the end of 1948, seven member banks had in active operation a total of 89 branches in 22 foreign countries and possessions of the United States. Of the 89 branches, four national banks were operating 83, and three State member banks were operating 6. The foreign branches in active operation were distributed geographically as follows:

Latin America	**46**
Argentina	10
Brazil	8
Chile	2
Colombia	3
Cuba	16
Mexico	1
Panama	3
Peru	1
Uruguay	1
Venezuela	1
Continental Europe	**5**
Belgium	1
France	1
Germany	3
England	**10**
Far East	**17**
China	1
Hong Kong	1
India	2
Japan	7
Philippines	5
Singapore	1
U. S. Possessions	**11**
Canal Zone	4
Puerto Rico	7
Total	**89**

At the end of 1948 there were four corporations organized under State laws which operate under agreements entered into with the Board pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged principally in international or foreign banking. These corporations are First of Boston International Corporation, International Banking Corporation, Morgan & Cie., Incorporated, and Bankers Company of New York. One of the four has no foreign affiliates or branches, one has a branch in England and during the year opened a branch in France, one operates a branch in France, and one has an English fiduciary affiliate.

During the year the agreement with the Board under which French American Banking Corporation operated was terminated, owing to the acquisition by other interests of the stock in the Corporation formerly held by member banks.

The Board's Division of Examinations examined during the year the head office of The Chase Bank, the one banking corporation in active operation organized under the provisions of Section 25(a) of the Federal Reserve Act and chartered by the Board to engage in international or foreign banking. The bank has a fiduciary affiliate in England, and operates a branch in France, two branches in China, and a branch in Hong Kong.

CHANGES IN REGULATIONS OF THE BOARD OF GOVERNORS

Reserves of member banks. The Board's Regulation D, relating to reserves required to be maintained by member banks with Federal Reserve Banks, was amended to increase the required reserves against demand deposits for banks in central reserve cities from 20 to 22 per cent effective February 27, 1948, and from 22 to 24 per cent effective June 11, 1948. It was again amended effective September 24, 1948, as to banks in reserve and central reserve cities, and effective September 16, 1948, as to other member banks, to increase the required reserves against time deposits from 6 to 7.5 per cent for all member banks, and to increase the required reserves against demand deposits from 24 to 26 per cent for central reserve city banks, from 20 to 22 per cent for reserve city banks, and from 14 to 16 per cent for other member banks. The regulation also was amended in minor respects effective September 16, 1948, to reflect changes in the applicable statutes.

Effective in May 1949, the Board reduced reserve requirements by 2 percentage points on net demand deposits at member banks in central reserve cities, by 1 percentage point on net demand deposits at all other member banks, and by one-half percentage point on time deposits at all member banks. These reductions became effective May 5, 1949 for member banks in reserve and central reserve cities and May 1, 1949 for other member banks.

Membership of State banks. The Board's Regulation H, relating to membership of State banks in the Federal Reserve System, was amended effective September 1, 1948, to eliminate certain conditions of membership which were not considered essential as standard conditions of membership for State member banks of the Federal Reserve System. This action was taken as part of a program to accomplish greater uniformity in the conditions of membership applicable to State member banks.

Check clearing and collection. The Board's Regulation J, relating to the clearing and collection of checks by Federal Reserve Banks, was amended effective January 1, 1949, pursuant to recommendations of the American Bankers Association, to permit conditional payment of checks and other cash items presented by Federal Reserve Banks. The amendment authorizes a procedure under which a cash item which a Federal Reserve Bank presents to a drawee bank, and for which remittance or settlement is made by the drawee bank on the day it receives the item, may be returned for credit or refund at any time prior to midnight of the drawee's next business day.

Interlocking bank directorates. The Board's Regulation L, relating to interlocking bank directorates under the Clayton Act, was amended effective July 1, 1948, to permit a director, officer, or employee of a member bank to be at the same time a director, officer, or employee of not more than one bank which is principally engaged in international or foreign banking and which does not receive deposits or make loans in the United States except as may be incidental to its international or foreign business.

Margin requirements for purchasing securities. The Board's Regulation T, relating to the extension and maintenance of credit by brokers, dealers, and members of national securities exchanges, and Regulation U, relating to loans by banks for the purpose of purchasing or carrying stocks registered on a national securities exchange, were amended effective April 1, 1948, to permit a customer to make substitutions on certain conditions in an undermargined account without having to supply additional margin. Previously, substitutions were limited by the rule that the proceeds of sales of securities in an undermargined account be used to the extent necessary to increase the margin on the remaining securities until it was on the margin basis prescribed by the regulations.

Effective March 30, 1949, the margin requirements under the Board's Regulations T and U were reduced from 75 per cent to 50 per cent. Effective May 1, 1949, these regulations were amended to simplify operations in the special cash account under Regulation T and to relax further the provisions relating to substitutions of securities under the regulations. Effective May 16 the regulations were amended to permit a 25 per cent margin in the case of securities acquired through subscription rights when specified conditions are met.

Consumer instalment credit. The Board's Regulation W, relating to consumer instalment credit, was reissued effective September 20, 1948, in much the same form as the regulation was when terminated on November 1, 1947. The new regulation covered instalment sales and loans for the purchase of 12 kinds of consumers' durable goods, excluding articles selling for less than $50. It also covered instalment loans for most other consumer purposes. The regulation required down payments of at least 33⅓ per cent on purchases of automobiles and 20 per cent on purchases of the other listed articles. On all types of instalment credit subject to the regulation, maturities were restricted to 15 months for credits not exceeding $1,000 and 18 months for larger amounts (with monthly payments of at least $70 on amounts over $1,000). Instalment credits in excess of $5,000 were not regulated. The regulation was amended effective November 1, 1948, to permit customer trials of appliances without prior down payments under certain specified conditions.

Effective January 1, 1949, Regulation W was amended to provide that, for purposes of the exemption of articles selling for less than $50, any applicable sales taxes might be disregarded. Effective March 7, 1949, the regulation was amended to reduce required down payments on articles other than automobiles from 20 per cent to 15 per cent and to increase to 21 months the maximum period permitted for repayment of all credits under the regulation. Certain technical changes were made at the same time. Effective April 27, 1949, the required down payment on articles other than automobiles was reduced to 10 per cent, the maximum period permitted for repayment of all credits under the regulation was increased to 24 months, and the exemption of articles selling under $50 was changed to an exemption of articles selling under $100.

LITIGATION

Suit regarding condition of membership. The Supreme Court of the United States on March 15, 1948 reversed the decision of the United States Court of Appeals for the District of Columbia in the suit of Peoples Bank, Lakewood Village, California, against the members of the Board of Governors. The suit asked for a declaration that a condition of membership accepted by the Peoples Bank at the time of its admission to membership in the Federal Reserve System was invalid and sought an injunction against its enforcement. The Supreme Court held that "the Bank's grievance here is too remote and insubstantial, too speculative in nature, to justify an injunction against the Board of Governors, and therefore equally inappropriate for a declaration of rights." Two Justices dissented and two Justices did not participate in the decision. A rehearing was denied April 19, 1948. The opinions of the Supreme Court are reported in 333 U. S. 426 and were printed in the *Federal Reserve Bulletin* for April 1948, pages 398-402.

Hearing under Clayton Antitrust Act. On June 24, 1948, the Board issued a complaint against Transamerica Corporation, a holding company having its principal place of business in San Francisco, California, together with a notice of a hearing to determine whether an order should be entered requiring the Corporation to cease and desist from violating Section 7 of the Clayton Antitrust Act, which vests specifically in the Board the responsibility for enforcement with respect to banks, banking associations, and trust companies. The complaint charged that the Corporation violated the Act by acquiring the stock of numerous banks. After certain preliminary motions had been heard and disposed of, the taking of testimony began before a Hearing Officer on February 2, 1949.

LEGISLATION

Consumer instalment credit. A Joint Resolution approved August 16, 1948, restored the Board's authority to regulate consumer credit for a period ending June 30, 1949, in accordance with Executive Order No. 8843, dated August 9, 1941, in so far as it relates to instalment credit. This authority had been terminated on November 1, 1947, by a Joint Resolution approved August 8, 1947.

Reserves of member banks. The Joint Resolution approved August 16, 1948, also amended Section 19 of the Federal Reserve Act to give the Board additional authority to increase the reserves required to be maintained by member banks with Federal Reserve Banks during a period ending June 30, 1949. This amendment authorized the Board to increase the required reserves against time deposits to a maximum of 7.5 per cent for all member banks and to increase the required reserves against demand deposits to not more than 30 per cent for central reserve city banks, 24 per cent for reserve city banks, and 18 per cent for other member banks.

Real-estate loans. An Act approved May 25, 1948, amended the third paragraph of Section 24 of the Federal Reserve Act, so as to make it clear that the restrictions and limitations of that section upon real-estate loans by national banks do not apply to loans which are made to established industrial or commercial businesses and in which the Reconstruction Finance Corporation cooperates or purchases a participation.

Criminal provisions. Under an Act approved June 25, 1948, which became effective September 1, 1948, Title 18 of the United States Code, entitled "Crimes and Criminal Procedure," was revised and codified into the criminal code. The Act repealed certain criminal provisions contained in Sections 12B and 22 of the Federal Reserve Act and in related statutes and incorporated the substance of these provisions in the revised Title 18.

RESERVE BANK OPERATIONS

Earnings and expenses. Current earnings and expenses of the various Federal Reserve Banks are given in detail in Table 6 on pages 70-71, and a condensed annual statement for all the Reserve Banks combined since 1914 is shown in Table 7 on pages 72-73. The table below gives a condensed comparative summary for all of the Reserve Banks for the years 1947 and 1948.

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS
1947 and 1948

[In thousands of dollars]

Item	1948	1947
Current earnings	304,161	158,656
Current expenses	72,710	65,393
Current net earnings	231,451	93,263
Additions to current net earnings	6,517	2,887
Deductions from current net earnings	414	508
Net additions	6,103	2,379
Transferred to reserves for contingencies	40,421	406
Paid U. S. Treasury (Sec. 13b)	....	36
Paid U. S. Treasury (interest on outstanding F. R. notes)	166,690	75,224
Net earnings after reserves and payments to U. S. Treasury	30,443	19,976
Dividends paid	11,920	11,523
Transferred to surplus (Sec. 13b)	....	87
Transferred to surplus (Sec. 7)	18,523	8,366

The increase of about 145 million dollars in current earnings in 1948 reflected principally an increase of 143 million in earnings on United States Government securities in the System Open Market Account. Current expenses increased only about 7 million dollars, so that current net earnings were 138 million more in 1948 than in 1947.

After net additions to current net earnings of 6 million dollars (consisting mostly of net profits on sales of United States Government securities) transfers to reserves for contingencies of 40 million, and payments of 167 million to the United States Treasury as interest on outstanding Federal Reserve notes, remaining net earnings were 30 million dollars in 1948. Dividends to member banks, as provided in the Federal Reserve Act, totaled about 12 million dollars, leaving 18 million, which was transferred to surplus.

As noted above, earnings on Reserve Bank holdings of United States Government securities were 143 million dollars more in 1948 than in 1947. This increase reflected a higher average rate of earnings in 1948, which resulted from a somewhat higher yield on Treasury bills and certificates and a shift from Treasury bills into bonds, with little change in total holdings. Earnings from discounts and advances were greater in 1948 than in 1947, reflecting the increases made in the Federal Reserve Bank discount rates in 1948, as well as a larger volume of loans. The accompanying table shows average holdings, earnings, and average rates of earnings on loans and securities of the Federal Reserve Banks during the past four years.

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1945–48
[Dollar amounts in thousands]

Item and year	Total	Discounts and advances	Acceptances purchased	U. S. Government securities, direct and guaranteed	Industrial loans
Average daily holdings:					
1945	$21,742,589	$375,958	$ 22	$21,363,244	$3,365
1946	23,570,260	310,308	8,457	23,250,195	1,300
1947[1]	22,552,491	218,755	384	22,331,740	1,612
1948[1]	21,841,623	330,706	....	21,509,321	1,596
Earnings:					
1945	141,631	1,977	(2)	139,553	101
1946	149,703	2,497	43	147,125	38
1947	157,823	2,195	4	155,564	60
1948	303,316	4,371	....	298,903	42
Average rate of earnings (per cent):					
1945	0.65	0.53	0.50	0.65	2.99
1946	0.64	0.80	0.51	0.63	2.90
1947	0.70	1.00	1.01	0.70	3.75
1948	1.39	1.32	....	1.39	2.64

[1] Based on holdings at opening of business.
[2] Less than $500.

Foreign transactions. Total dollar and gold assets of foreign central banks and governments held by the Federal Reserve Banks increased in 1948 by nearly 900 million dollars, thereby reversing the downward trend which had been in evidence since the high point of about 7 billion dollars was reached in September 1945. The increase, however, was less than the amount of foreign-owned gold that was shipped to this country during the year. At the end of the year, dollar deposits, earmarked gold, United States Government securities, and other dollar assets held for all such accounts amounted to about 4.2 billion dollars.

The rise in assets held for foreign account took the form largely of United States Government securities and dollar deposits, although the amount of gold held under earmark also showed a net increase of 195 million dollars for the year.

The amount of gold and dollar assets held by the Federal Reserve Bank of New York for the International Bank for Reconstruction and Development and the International Monetary Fund increased only moderately. This contrasted with the sharp net rise in 1947, when member countries made large payments covering their participation in the Fund and the Bank.

As a result of increased demands from foreign central banks for loans against gold, the total of such loans outstanding rose from about 50 million dollars at the end of 1947 to a new record high of nearly 260 million in August, but then receded to about 190 million at the end of 1948. These loans, which were designed to cover temporary requirements for dollar exchange on the part of the borrowing countries, were made for periods not exceeding three months. Interest was at the discount rate of the Federal Reserve Bank of New York, which was raised from 1 to 1½ per cent during the year. Of four loans on gold outstanding at the beginning of the year, two were repaid in full, and one in part during the year. Loans were made to five other central banks during the year, of which two were repaid in full, while the amount advanced to the other three had been considerably reduced by the end of the year.

Three regular foreign accounts were opened during the year, one of which represented the transfer of a balance from an account which the Federal Reserve Bank of New York had previously maintained as fiscal agent of the United States.

The Federal Reserve Bank of New York, as fiscal agent of the United States, continued to operate the United States Stabilization Fund in accordance with authorization and instructions from the Treasury Department and to act in a fiscal agency capacity in the administration of foreign funds control. Under the Executive Order of January 15, 1934, and Treasury regulations issued thereunder, the Federal Reserve Banks continued to collect and analyze reports from banks, security brokers and dealers, and others covering the international movement of capital.

The Federal Reserve Bank of New York handled a variety of operations during the year for the International Bank for Reconstruction and Development and the International Monetary Fund. Operations undertaken for the International Bank included making investments in United States Government securities, holding securities in custody, receiving deposits, making payments under loans granted by the Bank, and acting as fiscal agent of the Bank in connection with its two bond issues floated in 1947. For the Fund, the operations consisted largely of making dollar payments in connection with its foreign exchange and gold transactions with member countries, and of holding gold and securities in custody.

Volume of operations. Operations in the principal departments of the Federal Reserve Banks during 1948 were on the whole somewhat higher than in 1947 and checks collected and currency and coins handled registered increases to new all-time peaks. As in the preceding two years of adjustment from a war economy, there was some decline in 1948 in the number of issues, redemptions, and exchanges of Government securities by Reserve Banks acting as fiscal agents for the United States Treasury and Government agencies. Volume of operation figures for 1948 as compared with the previous four years are shown in Table 5 on page 69.

Bank premises. The policy stated in the 1947 Annual Report of approving the preparation of plans for needed building construction or extensive alterations and repairs at Federal Reserve Banks and their branches but not authorizing commencement of construction unless of an emergency character was continued during 1948.

Under this policy the only construction projects authorized in 1948 were completion of the rehabilitation of the building acquired by the Federal Reserve Bank of St. Louis in 1944, air conditioning of a few floors at the Federal Reserve Bank of Chicago in order to complete the air conditioning of the building, and construction of a coin vault in the Detroit Branch of the Federal Reserve Bank of Chicago.

In addition, the Federal Reserve Bank of San Francisco was authorized to proceed with the preparation of final plans for the construction of buildings to house its Portland and Seattle Branches on sites acquired in 1946 and 1945, respectively, and to execute purchase contracts for structural steel and elevators for these buildings. The Portland and Seattle Branches occupy rented quarters, and in each case the owners of the buildings have asked that the space be vacated as soon as possible for other use.

RESERVE BANK PERSONNEL

Chairmen and Deputy Chairmen. One of the three Class C directors appointed by the Board of Governors for each Federal Reserve Bank is designated annually to serve as Chairman of the Board of Directors and as Federal Reserve Agent, and another Class C director is appointed annually as Deputy Chairman. A list of the Chairmen and Deputy Chairmen is shown on page 106.

The Chairmen and Deputy Chairmen at the Federal Reserve Banks were redesignated to serve as such for the year 1948, except for the following changes:

Harold D. Hodgkinson, Vice President, General Manager and Chairman of Management Board, Wm. Filene's Sons Company, Boston, Massachusetts, who had been a Class C director of the Federal Reserve Bank of Boston since January 1, 1947, was appointed Deputy Chairman for the year 1948.

Robert T. Stevens, Chairman of the Board, J. P. Stevens and Company, Inc., New York, New York, was appointed a Class C director of the Federal Reserve Bank of New York on May 14, and designated Chairman and Federal Reserve Agent for the remaining portion of the year 1948. He formerly served as a Class B director of the Federal Reserve Bank of New York from January 1, 1934, to January 8, 1942, when he was called into active service with the United States Army.

Wm. H. Bryce, Vice President, Dixie Wax Paper Company, Memphis, Tennessee, was appointed a Class C director of the Federal Reserve Bank of St. Louis on March 22, and Deputy Chairman for the remaining portion of the year 1948.

Directors. A list of the directors of the Federal Reserve Banks and Branches as of the close of the year is shown on pages 107-15.

The Board of Governors made the following appointments of new directors either for terms beginning January 1, 1948, or to fill vacancies during the year:

Class C Directors. Ames Stevens, Treasurer, Ames Worsted Company, Lowell, Massachusetts, was appointed a Class C director of the Federal Reserve Bank of Boston on July 26.

Robert T. Stevens, Chairman of the Board, J. P. Stevens and Company, Inc., New York, New York, was appointed a Class C director of the Federal Reserve Bank of New York on May 14.

Allan B. Kline, President, American Farm Bureau Federation, Chicago, Illinois, was appointed a Class C director of the Federal Reserve Bank of Chicago for the term beginning January 1, 1948.

Wm. H. Bryce, Vice President, Dixie Wax Paper Company, Memphis, Tennessee, was appointed a Class C director of the Federal Reserve Bank of St. Louis on March 22.

Branch Directors. Lewis B. Swift, President, Taylor Instrument Companies, Rochester, New York, was appointed a director of the Buffalo Branch of the Federal Reserve Bank of New York on January 23.

R. E. Ebert, President, Dixie Home Stores, Inc., Greenville, South Carolina, was appointed a director of the Charlotte Branch of the Federal Reserve Bank of Richmond for the term beginning January 1, 1948.

J. Roy Faucett, a partner of Faucett Brothers, Northport, Alabama, was appointed a director of the Birmingham Branch of the Federal Reserve Bank of Atlanta for the term beginning January 1, 1948.

Marshall F. Howell, Secretary-Treasurer, Bond-Howell Lumber Company, Jacksonville, Florida, was appointed a director of the Jacksonville Branch of the Federal Reserve Bank of Atlanta for the term beginning January 1, 1948.

Howard Phillips, Vice President and General Manager, Dr. P. Phillips Company, Orlando, Florida, was appointed a director of the Jacksonville Branch of the Federal Reserve Bank of Atlanta on February 5. Mr. Phillips formerly served as a director of the Jacksonville Branch from February 28, 1938, to April 18, 1942, when he was called to active service in the Army of the United States.

J. Hillis Miller, President, University of Florida, Gainesville, Florida, was appointed a director of the Jacksonville Branch of the Federal Reserve Bank of Atlanta on August 16.

C. E. Brehm, Acting President, University of Tennessee, Knoxville, Tennessee, was appointed a director of the Nashville Branch of the Federal Reserve Bank of Atlanta for the term beginning January 1, 1948.

Ben R. Marsh, Vice President and General Manager, Michigan Bell Telephone Company, Detroit, Michigan, was appointed a director of the Detroit Branch of the Federal Reserve Bank of Chicago for the term beginning January 1, 1948.

A. Howard Stebbins, Sr., Chairman of Board, Stebbins and Roberts, Inc., Little Rock, Arkansas, was appointed a director of the Little Rock Branch of the Federal Reserve Bank of St. Louis on February 11.

Alvin A. Voit, President, The Mengel Company, Louisville, Kentucky, was appointed a director of the Louisville Branch of the Federal Reserve Bank of St. Louis on January 20.

Smith D. Broadbent, Jr., of Cadiz, Kentucky, was appointed a director of the Louisville Branch of the Federal Reserve Bank of St. Louis on June 15. Mr. Broadbent is engaged in farming.

M. P. Moore, a partner of E. E. Moore and Company, Senatobia, Mississippi, was appointed a director of the Memphis Branch of the Federal Reserve Bank of St. Louis for the term beginning January 1, 1948.

C. W. Cotton, President, C. W. Cotton Supply Company, Tulsa, Oklahoma, was appointed a director of the Oklahoma City Branch of the Federal Reserve Bank of Kansas City for the term beginning January 1, 1948.

Joseph W. Seacrest, Co-Publisher, Nebraska State Journal, Lincoln, Nebraska, was appointed a director of the Omaha Branch of the Federal Reserve Bank of Kansas City on April 16.

Edward E. Hale, Chairman of the Department and Professor of Economics, University of Texas, Austin, Texas, was appointed a director of the San Antonio Branch of the Federal Reserve Bank of Dallas for the term beginning January 1, 1948.

Henry C. Isaacson, President, Isaacson Iron Works, Seattle, Washington, was appointed a director of the Seattle Branch of the Federal Reserve Bank of San Francisco on January 16.

Change in Presidents. Laurence F. Whittemore resigned as President of the Federal Reserve Bank of Boston effective October 4, to become President of the New York, New Haven and Hartford Railroad Company. Mr. Whittemore had served as a Class B director from September 7, 1944, to February 28, 1946, and as President of the Bank since March 1, 1946.

Joseph A. Erickson was appointed President of the Federal Reserve Bank of Boston to succeed Mr. Whittemore and assumed office on December 15. Mr. Erickson formerly was Executive Vice President of the National Shawmut Bank of Boston.

Staff. At the end of 1948, the total number of officers and employees of the twelve Federal Reserve Banks and their twenty-four branches was 19,087, representing a decline of 277 since the end of 1947. The total Reserve Bank personnel has declined steadily since 1943 when it was at its peak owing to the great expansion in the volume of operations resulting from the war. The total number of officers and employees of the Reserve Banks and Branches at the end of each year beginning with 1941 was as follows:

1941	14,083	1945	23,522
1942	19,972	1946	21,430
1943	24,741	1947	19,364
1944	24,442	1948	19,087

BOARD OF GOVERNORS—STAFF

Appointments of Board members and designation of Chairman. The appointment of Thomas B. McCabe, of Pennsylvania, as a member of the Board of Governors for the unexpired portion of the term ending January 31, 1956, was approved by the Senate on April 12. On April 15 the President designated him as Chairman of the Board for a four-year term and he took the oath of office as a member of the Board.

M. S. Szymczak, of Illinois, whose term as a member of the Board of Governors expired on January 31, 1948, was reappointed by the President and confirmed by the Senate for an additional term of 14 years.

Staff. On December 31, 1948, the Board's staff, exclusive of those on leave without pay, numbered 517, as compared to 504 at the end of 1947.

Carl E. Parry, Director of the Division of Security Loans, retired March 31, as a member of the Board's staff, under the provisions of the Federal Reserve Retirement System. Mr. Parry became associated with the Board on October 1, 1924, and had served as Director of the Division of Security Loans since November 24, 1934.

Winfield W. Riefler rejoined the Board's staff on May 10, as Assistant to the Chairman of the Board. He was a member of the research staff of the Board of Governors from 1923 to 1933 and a director of the Federal Reserve Bank of Philadelphia in 1941 and 1942. Mr. Riefler had been a professor at the Institute for Advanced Study, Princeton, New Jersey, since 1935 and has served as an officer or director of several organizations engaged in economic research. From 1942 to 1944 he was in London as United States Minister and Special Assistant to the Ambassador.

J. Burke Knapp resigned as an Assistant Director of the Board's Division of Research and Statistics effective May 23, to accept a position with the Department of State. Mr. Knapp was associated with the Board's Division of Research and Statistics from February 1940 to August 1944, when he resigned to accept a position with the Department of State. He returned to the Board in October 1945, and served as Special Assistant to the Chairman until June 1, 1946, when he was appointed an Assistant Director of the Division of Research and Statistics.

Frank A. Southard, Jr., was appointed an Associate Director of the Board's Division of Research and Statistics to be in charge of all international activities of the Division and assumed his duties on August 16. Mr. Southard was Chairman of the Department of Economics at Cornell University and was on leave of absence serving as Director of the Office of International Finance of the Treasury Department at that time. During the war, he was Financial Adviser at the Allied Force Headquarters in the Mediterranean.

Robert F. Leonard, formerly the Director of the Division of Examinations, was appointed Associate Director of the Division of Bank Operations, effective September 1. Mr. Leonard became Director of the Division of Bank Operations on January 1, 1949, following the retirement of Mr. Smead, former Director, at the end of 1948.

Edwin R. Millard, formerly an Assistant Director of the Division of Examinations, was appointed Director of the Division of Examinations to succeed Mr. Leonard, effective September 1.

Frederic Solomon and John C. Baumann were appointed Assistant General Counsel, effective August 13. Mr. Solomon and Mr. Baumann had been Assistant Counsel in the Board's Legal Division for a number of years.

Bonnar Brown resigned as Assistant Director of the Division of Research and Statistics effective October 15, to become associated with the Stanford Research Institute, Stanford, California. On October 1, 1937, Mr. Brown was employed as a member of the staff of the Division of Security Loans and served as Assistant Director of that Division from July 1, 1944, until October 1, 1947, when he was appointed Assistant Director of the Division of Research and Statistics.

On December 6, the title of J. Leonard Townsend, formerly Associate General Counsel of the Board's Legal Division, was changed to that of Solicitor. Mr. Townsend assumed charge of a separate division in the Board's organization which is responsible for the representation of the Board in all litigation to which the Board may be a party, and for the institution and conduct of all formal proceedings by or on behalf of the Board to enforce provisions of law or of the Board's regulations. As Solicitor, Mr. Townsend also continues to handle questions arising in connection with the proposed legislation relating to the regulation of bank holding companies.

Prior to his association with the Board's legal staff, Mr. Townsend had been Assistant Solicitor of the Securities and Exchange Commission. Before entering government service, Mr. Townsend had been engaged in the general practice of law in Washington with the Honorable A. Mitchell Palmer, former Attorney General of the United States, and with the Honorable James M. Beck, former Solicitor General of the United States.

Clarence C. Hostrup was appointed an Assistant Director of the Division of Examinations effective December 12. Mr. Hostrup became associated with the Board on October 1, 1933, and had been a Federal Reserve Examiner since January 1, 1934.

Edward L. Smead, Director of the Division of Bank Operations, retired at the end of the year as a member of the Board's staff, under the provisions of the Federal Reserve Retirement System. Mr. Smead became associated with the Board on April 19, 1915, and had served as Director of the Division of Bank Operations since April 12, 1920. Mr. Smead also served successively as Acting Administrator for the War Loans Committee and Administrator for War Loans during the period from October 1942 to August 1946.

J. R. Van Fossen, Assistant Director of the Division of Bank Operations, also retired as of the close of the year as a member of the Board's staff, under the provisions of the Federal Reserve Retirement System. Mr. Van Fossen joined the Board's staff on October 22, 1917, and had served as Assistant Director of the Division of Bank Operations since January 1, 1922.

BOARD OF GOVERNORS—INCOME AND EXPENSES

The following table shows the income and expenses of the Board for the year 1948:

OPERATING SURPLUS, January 1, 1948		$ 340,067.67	
Adjustment in 1948 applicable to preceding years		917.46	$ 339,150.21
INCOME:			
Assessments on Federal Reserve Banks		3,243,670.69	
Sale of *Federal Reserve Bulletin*		14,916.82	
Sale of other publications		29,121.25	
Miscellaneous		6,712.81	3,294,421.57
			3,633,571.78
EXPENSES:			
Salaries		2,083,777.12	
Retirement contributions—regular		150,867.05	
Retirement contributions—special		421,972.00	
Traveling expenses		146,307.72	
Postage and expressage		19,227.31	
Telephone and telegraph		62,596.51	
Printing and binding		139,778.69	
Stationery and supplies		27,022.01	
Furniture and equipment, including rental		35,402.65	
Books and subscriptions		10,932.15	
Heat, light, and power		32,811.50	
Repairs and alterations (building and grounds)		7,338.59	
Repairs and maintenance (furniture and equipment)		4,797.42	
Medical service and supplies		1,139.51	
Insurance		2,663.02	
Miscellaneous:			
Survey of consumer finances	$127,597.19		
Cafeteria (net)	30,933.89		
All other	17,237.85	175,768.93	3,322,402.18
OPERATING SURPLUS, December 31, 1948			$ 311,169.60

In addition to the foregoing, the Board made certain expenditures on a reimbursable basis for which it received reimbursements in 1948 as follows:

Printing Federal Reserve notes, including cost of additional equipment	$3,533,182.00
Leased wire service (telegraph)	96,561.22
Leased telephone lines	9,684.00
Federal Reserve Issue and Redemption Division (Comptroller of the Currency)	89,511.90
Miscellaneous	17,826.25

The accounts of the Board for the year 1948 were audited by the Auditor of the Federal Reserve Bank of New York, who certified them to be correct.

RESEARCH AND ADVISORY SERVICES

Analysis of conditions affecting the availability and use of money continued to be the major objective of the Board's research activities during 1948. Subjects of special importance included Treasury financing and the market for Government securities, bank and nonbank credit, the capital markets, liquid asset holdings and current saving, production and employment, prices, gross national product and individual incomes, and the effect of foreign commitments on domestic resources.

On several occasions, members of the Board appeared before congressional committees to give information regarding monetary and credit conditions and the ability of the Federal Reserve to meet possible contingencies. Members of the Board's staff assisted congressional committees to investigate special problems and participated in public and private conferences relating to agricultural credit, building codes, home mortgage credit, industrial classification, and national income and productivity. Staff members also served on many interdepartmental committees concerned with analysis of particular economic developments and the improvement of statistics and other information required to interpret current developments.

A third annual survey of consumer finances was sponsored by the Board of Governors early in 1948 to obtain information regarding changes in the financial position of consumers. The data collected also reflected the attitude of consumers toward the economic outlook and their plans with respect to saving, liquid asset holdings, and investment. The survey was conducted for the Board by the Survey Research Center, a division of the Institute for Social Research, University of Michigan. The results were published in the *Federal Reserve Bulletin*. A fourth annual survey is being conducted in 1949.

Work has continued on the study of the flow of money payments. Financial statements tracing these flows on an annual basis have been completed for most sectors of the economy, covering the period from 1936 to 1947. The statement showing the flow of funds through the banking sector was published in the January 1948 *Bulletin*.

The Board of Governors sponsored the publication of the pamphlet, *Distribution of Bank Deposits by Counties,* showing demand and time deposits of individuals, partnerships, and corporations in all banks by counties, States, and Federal Reserve districts, as of December 31, 1947. Data for national banks and banks in the District of Columbia were obtained by the Comptroller of the Currency, for State member banks by the Board of Governors of the Federal Reserve System, and for nonmember banks by the Federal Deposit Insurance Corporation; data for noninsured banks were obtained with the cooperation of the State bank supervisory authorities. The pamphlet was published in July 1948. Corresponding data for the war years 1941-44, obtained in the same manner, are available in pamphlets published by the Treasury Department.

Early in 1948 the Board of Governors and the Federal Reserve Banks conducted a nation-wide survey of the lending operations of sales finance companies during 1947. The results of the survey, which complement the release on the activities of sales finance companies issued monthly by the Board of Governors, were published in the *Bulletin* for July 1948.

Progress was made in revising and supplementing the Board's regular statistical series to improve their composition and increase their usefulness for analysis of current developments. The quarterly series of interest rates on bank loans to business was completely revised to take account of the new and more satisfactory data that have recently become available through Federal Reserve surveys. The revised series was first published in the *Bulletin* for March 1949. The new monthly series of assets and liabilities of all banks in the United States, referred to in the Board's Annual Report for 1947, was completed and published for the first time in the *Bulletin* for April 1948. This series continues the semi-annual data published by the Board over a long period, and is comparable with the semi-annual series announced by the three Federal bank supervisory authorities as of June 30, 1947 except for exclusion of banks in the possessions of the United States.

Various components of the Board's consumer credit statistics were revised to give them broader coverage or to make them more representative of short-term credit. The revision was described in the *Bulletin* for August 1948. Following discussions with the trade, the Board's statistics on department store sales and stocks were expanded to include data for additional sub-departments and published on the new basis beginning with April 1948.

In connection with the increased activities of the United States in world affairs, the Board's staff continued to provide studies in the international economic and financial field to help furnish a basis for United States policy decisions. As in the two preceding years, a large part of this work was closely geared to the activities of the National Advisory Council on International Monetary and Financial Problems, of which the Chairman of the Board of

Governors is a member. Members of the Board's staff collaborated closely with the other agencies represented on the Council, and were active in interdepartmental committees and working groups preparing material for use by the Council. The Council gave close attention to financial problems arising under the European Recovery Program and to important questions dealing with other foreign lending and assistance activities of the United States and with policies and operations of the International Fund and the International Bank. The Board's staff also continued to work on the special problems and operating responsibilities of the Federal Reserve System in the international field.

The Board continued to cooperate in projects of an international nature by supplying members of its staff for assignments abroad. Early in the year, two of the Board's economists spent three months in Manila assisting representatives of the Philippine Government in drafting central bank legislation. In March, two examiners from the Board's staff with one representative each from the Federal Reserve Banks of Richmond and Chicago, went to Haiti at the request of the Haitian Government as members of a mission to examine the Banque Nationale de la Republique d'Haiti. In the late spring, one of the Associate Directors of the Board's Division of Research and Statistics headed a financial mission to Japan, and an economist from the Board's staff was also a member of this mission. At the end of August, a member of the Board's staff was assigned as an adviser to the Joint Brazil-United States Technical Commission for a period of four months; a Vice President of the Federal Reserve Bank of New York was one of the three members of this Commission. In the fall of the year, a member of the Board's staff was sent abroad to study economic and financial conditions in France and Italy. Late in the year, one of the Board's economists was given six months' leave of absence to act as General Policy Adviser to the Central Bank of the Philippines, and another economist was lent to the Government of Ceylon for a period of six months to assist representatives of that government in drafting central bank legislation. In addition, the Board from time to time provided the services of members of its staff to the Economic Cooperation Administration to assist in work on specific problems.

The Board had numerous visitors from foreign central banks and governments who had come to the United States for official negotiations or for consultation with financial authorities, international organizations, bankers, and others. It also facilitated the work of visitors who had come for the study of American banking, supervisory methods, and related matters.

PUBLICATIONS AND RELEASES

During the year 1948, interest in the Board's publications and releases continued to increase. There was a special demand for the 1947 edition of the publication entitled, THE FEDERAL RESERVE SYSTEM—ITS PURPOSES

AND FUNCTIONS. This booklet was used extensively in teaching and training programs of educational and business institutions. Several periodic releases were initiated. In addition to regulations and various reprints, the following publications were issued:

FEDERAL RESERVE BULLETIN. Issued monthly.

FEDERAL RESERVE CHARTS ON BANK CREDIT, MONEY RATES, AND BUSINESS. Issued monthly.

MEMBER BANK CALL REPORT. Three issues, one each in April, July, and October.

STATE BANK MEMBERS AND NONMEMBER BANKS THAT MAINTAIN CLEARING ACCOUNTS WITH FEDERAL RESERVE BANKS. Complete list in February with monthly supplements.

LIST OF STOCKS REGISTERED ON NATIONAL SECURITIES EXCHANGES. Complete list in February with supplements in May, August, and November.

BANKING STUDIES (1941). Reprinted in March.

THIRTY-FOURTH ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. Published in May.

RETAIL CREDIT SURVEY—1947. Published in July.

DISTRIBUTION OF BANK DEPOSITS BY COUNTIES, December 31, 1947. Published in July.

PAR LIST. Complete list in August with monthly supplements.

FEDERAL RESERVE MEETINGS

The Federal Open Market Committee met in Washington on February 27, March 1, May 20, October 4, November 15, and November 30, 1948, and the executive committee of the full Committee met from time to time during the year. Under the provisions of Section 12A of the Federal Reserve Act, the Federal Open Market Committee has responsibility for determining the policies under which the open market operations of the Reserve Banks will be carried out. A record of the actions taken by the Committee on questions of policy will be found on pages 94-99 of this report.

Conferences of the Chairmen of the Federal Reserve Banks were held on May 29-31 and December 9-10, and were attended by members of the Board of Governors.

The Conference of Presidents of the Federal Reserve Banks held meetings on February 25-26, May 18, October 1-2, and November 29, and the Board of Governors met with the Presidents on February 27, May 21, October 5, and December 1.

Meetings of the Federal Advisory Council were held on February 15-17, April 25-27, September 19-21, and November 14-16. The Board of Governors met with the Council on February 17, April 27, September 21, and

November 16. The Council is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with and advise the Board in all matters within the jurisdiction of the Board.

During the year conferences were held by each of the following, attended by representatives of the Federal Reserve Banks and of the Board of Governors: Federal Reserve Bank officers in charge of examination departments, trust examiners, personnel concerned with accounting, and personnel administering Regulation W (consumer instalment credit). Meetings were held with Committees of the Presidents' Conference, such as the Committee on Collections and the Subcommittee on Personnel; and representatives of the Board met also with other groups to discuss international monetary and credit matters, domestic credit problems, bank holding company legislation, consumer credit statistics, and other subjects with which the Board was concerned.

ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Moderate economic recession followed by upturn in this country and abatement of inflationary trends in other economies of the free world marked the year 1949, covered by this Thirty-sixth Annual Report of the Board of Governors of the Federal Reserve System. These changes led to more flexible use of domestic monetary and credit measures in the United States and to widespread readjustment of foreign exchange rates as a further step toward reestablishing a freer flow of international trade and convertibility of currencies.

In this country, by the beginning of 1949—following three years of near-capacity production with generally rising prices—supplies of many types of goods exceeded demand at prevailing prices. Inventory accumulation in anticipation of rising prices and capital expenditures by business began to decline. Recessionary tendencies set in, and during the first half of the year prices of farm products and foods followed a downward trend begun in 1948. Prices of other products also declined, particularly in the case of some industrial materials; industrial production and employment fell off, and there was a moderate reduction in bank loans.

About midyear, readjustment of prices and business inventories, together with continuation of strong consumer demand and relaxation of credit conditions, combined to check further recession. Subsequently, prices steadied, industrial production and employment expanded, and credit growth was resumed. At the year-end, prices, production, and employment had not regained the high levels of a year earlier, but the money supply in the hands of the public had reached a level only slightly below the postwar peak at the end of 1947.

In other free economies, the shift in the general economic situation reflected the cumulative influence of further progress in postwar recovery, of more nearly adequate supplies of primary goods such as foods and fuels, and of policies directed toward monetary and fiscal stability. Inflationary forces were no longer as dominant as they had been earlier. Under the impact of these developments, as well as of moderate recession in this country, industrial production abroad increased somewhat less rapidly than it had before. With imports from the United States continuing at a very high level—sustained in part by this country's program of foreign aid—and with a decline in exports to the United States, the dollar gap on current account increased in many instances. In the case of the United Kingdom, this led to a serious decline in gold and dollar reserves.

To meet this adverse development and, more basically, to provide needed strengthening of trade positions in world markets, numerous countries, beginning with the United Kingdom in September, devalued their currencies sharply in relation to the dollar. The devaluation was by 30.5 per cent in the case of the pound sterling and several other currencies and by varying amounts for the remainder. This action, taken at a time when the economic situation in the United States was improving, was followed by some increase in shipments of goods to the United States. There was also a decline in imports from the United States, and apparently some repatriation of capital. As a result, the reserve positions of many countries improved. The levels attained, however, were not generally sufficient to provide a cushion adequate for a self-sustaining system of international trade with currency convertibility at stable exchange rates.

Following devaluation, price developments abroad were highly selective. For many finished products exported to the United States, dollar prices declined, generally by less than the extent of devaluation. Dollar prices of some other finished products showed no change. For most leading materials traded internationally, dollar prices were as high at the end of the year as they were before devaluation, although they had declined temporarily in the autumn. Thus, prices of these materials in devalued currencies were up sharply, but for the most part living costs abroad did not advance at this time. For the year as a whole, prices and living costs in other free countries showed much less rise than in other postwar years and, with supplies more nearly adequate, rationing and price controls were eased.

While the recession in this country during the first half of 1949 appeared to mark an important turning point in postwar economic development, the readjustment was moderate, reflecting the continued existence of deferred demands, notably for passenger automobiles, houses, and public construction. The moderate nature of the recession also reflected increased Government expenditures, the influence of some price reductions, and adjustment of production patterns and of consumer and business demands generally. In addition, the wider diffusion and availability of credit were factors of importance.

At the same time many basic problems of adaptation remained to be met. Within the United States, these included the various problems of maintaining stability with growth in a peacetime economy in which expenditures for military and foreign aid would continue to be large and an abundant supply of money and credit would be readily available. In the international field, there continued to be a dollar gap, pressure for further adjustment in patterns of trade and finance in response to devaluation of currencies, and a need for further progress towards freer exchange of goods, convertibility of currencies, and an expanding world trade. The paramount problem of maintaining world peace continued to overshadow all others.

FEDERAL RESERVE CREDIT POLICY IN 1949

Throughout the year 1949, the general and selective instruments available to the Federal Reserve authorities were coordinated in a flexible program for adjusting the availability and cost of credit to the changing needs of the economy. As downward trends in business activity, employment, and prices appeared early in the year, the Board of Governors shifted the emphasis of credit policy from restraint to ease. Toward the end of the year, after increasing evidence of economic recovery, the open market operations of the Federal Reserve permitted short-term money rates to rise in response to growing demand for credit.

As the Board has repeatedly emphasized, beginning with its Annual Report for 1945, the Reserve System lacked adequate means of restraining excessive credit expansion during the early postwar years. In striving at that time to moderate inflationary dangers, the

System used such measures as it had at its disposal, including margin requirements, regulation of consumer instalment credit, discount rates, reserve requirements, and moderate increases in short-term money rates. Nevertheless easy money conditions with relatively low rates prevailed throughout this period of acute inflationary pressures. Because the System had not been in a position to exert greater monetary restraints, it had less scope for reversal of policy when the time came to relax credit restraints. Notwithstanding these limitations, the System acted promptly to adjust monetary and credit policy to the changed conditions of early 1949.

The measures first adopted were directed toward easing terms in the areas of consumer instalment credit and stock market credit. As business reaction proceeded and bank loans declined, the System's restrictions were eased on the general availability of credit, particularly bank credit. By midyear, developments in the money market indicated that the lodgment of the large postwar volume of United States Government securities had become more stable and that open market operations could be conducted more with a view to the general credit needs of commerce, industry, and agriculture than to maintaining a fixed structure of yields on Government securities.

Reduction in reserve requirements. By successive reductions in reserve requirements during 1949, the Board of Governors progressively eased the anti-inflationary reserve policy previously followed. Bank credit to private borrowers, following a significant slackening of expansion late in 1948, declined moderately during the first half of 1949, reflecting a sharp decline in loans to business. The volume of privately held deposits and currency also declined somewhat more than seasonally. Whereas slower expansion of bank credit in the latter part of 1948 had been partly induced by anti-inflationary measures taken by the Federal Reserve authorities and by voluntary restraint in lending on the part of banks, the decline after the turn of the year reflected primarily the liquidation of business inventories that accompanied continuing downward adjustments in production and prices.

In view of this change in credit developments, the Board reduced reserve requirements early in May and again in August. Required reserves were also released on June 30 by the expiration of the Board's temporary additional authority over reserve requirements. These three reductions lowered the requirements against demand deposits by 4 percentage points and those against time deposits by 2½ percentage points at all classes of member banks. A total of 3.8 billion dollars of reserves was released to banks within four months, including about 1 billion at central reserve city banks in New York and Chicago and about 1.4 billion each at reserve city banks and country banks. The reductions in requirements re-established approximately the same reserve percentages that had been in effect during most of the period 1938-41. The changes in reserve requirements and their effective dates are shown in the table.

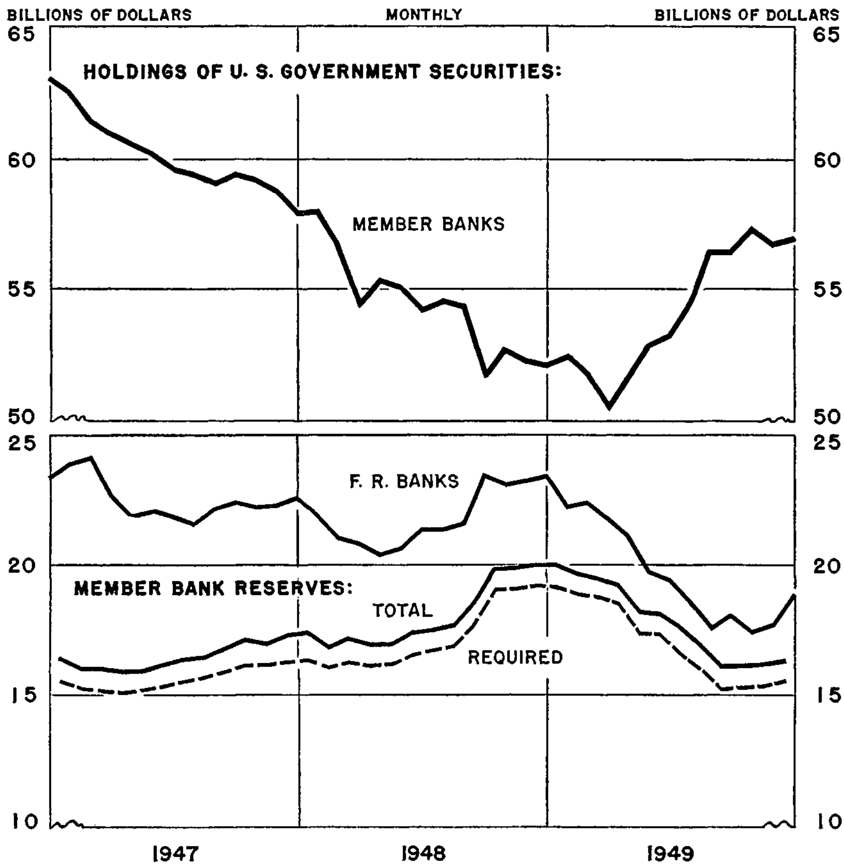
MEMBER BANK RESERVE REQUIREMENTS IN 1949

[Percentage of deposits]

Date	Net demand deposits			Time deposits	
	Central reserve city banks	Reserve city banks	Country banks	Central reserve and reserve city banks	Country banks
In effect, Jan. 1, 1948	20	20	14	6	6
Jan. 1, 1949	26	22	16	7½	7½
Changes in 1949, effective—					
May 1	....	....	15	....	7
May 5	24	21	....	7	....
June 30	....	20	....	6	....
July 1	....	....	14	....	6
August 1	....	....	13	....	....
August 11	23½	19½	....	5	....
August 16	....	....	12	....	5
August 18	23	19	....	....	....
August 25	22½	18½	....	....	....
September 1	22	18	....	....	....
In effect, Sept. 1–Dec. 31	22	18	12	5	5

By April 28, when the Board announced the May reduction in reserve requirements, there had been a decline of approximately 1.2 billion dollars in member bank loans since the first of the year. Of this decline, which exceeded substantially the usual seasonal decline, about one-half had been at central reserve city banks and the remainder at reserve city banks. In consideration of this development, and also of the fact that requirements at central reserve city banks had been increased by 6 percentage points during 1948, the Board reduced requirements by 2 percentage points on net demand deposits for these banks as compared with 1 percentage point for all other member banks.

MEMBER BANK RESERVES AND
HOLDINGS OF U. S. GOVERNMENT SECURITIES



Most of the funds released by this first easing of reserve requirements went into the Government securities market, as shown in the chart. Banks purchased large amounts of short- and medium-term issues. The Federal Reserve Banks supplied the short-term issues in order to prevent a disorderly decline in short-term yields, and institutional investors supplied most of the medium-term issues and used the proceeds to purchase long-term bonds that were ineligible for bank purchase. The principal effect of this reduction in reserve requirements was an expansion of bank portfolios of short-term Government securities.

With the expiration at the end of June of the Board's temporary additional authority over member bank reserves, there was another reduction in reserve requirements. Member banks again entered the market to acquire short- and medium-term Government securities and at the same time there was a strong demand by nonbank investors for long-term securities. In this period, pursuant to the action of the Federal Open Market Committee described below, the Federal Reserve made short-term securities available at somewhat lower yields and discontinued sales of Treasury bonds. The moderate decline in yields on Government securities that followed these actions had the effect of making Government securities a less attractive alternative to business and other loans, and, together with the further increase in bank liquidity, was conducive to more lenient lending policies by banks.

Early in August the Board announced a third reduction in reserve requirements, which became effective gradually through September 1. About the same time a renewed expansion of bank loans, which continued through the remainder of the year, increased bank deposits and consequently the amount of reserves required by member banks. Part of the reserves released by the Board's action was absorbed by this expansion, but the greater part was used to purchase short-term Government securities which were made available from the Federal Reserve portfolio.

More flexible open market operations. Government securities were in strong demand throughout 1949. The measures taken by the Federal Reserve and the Treasury to permit a rise in short-term rates between mid-1947 and October 1948 had encouraged banks to increase their holdings of short-term Government issues, and the widespread selling of Government bonds by savings institutions and other nonbank holders had slackened by the end of 1948. Without relinquishing its objective of maintaining orderly conditions in the Government securities market, the Federal Reserve was in a position to initiate a more flexible open market policy that could be integrated with policies relating to reserve requirements and discount rates and adapted to the credit needs of the economy. During most of 1949 Federal Reserve policies were directed primarily toward assuring private borrowers that ample credit would be available to facilitate readjustments in the economy.

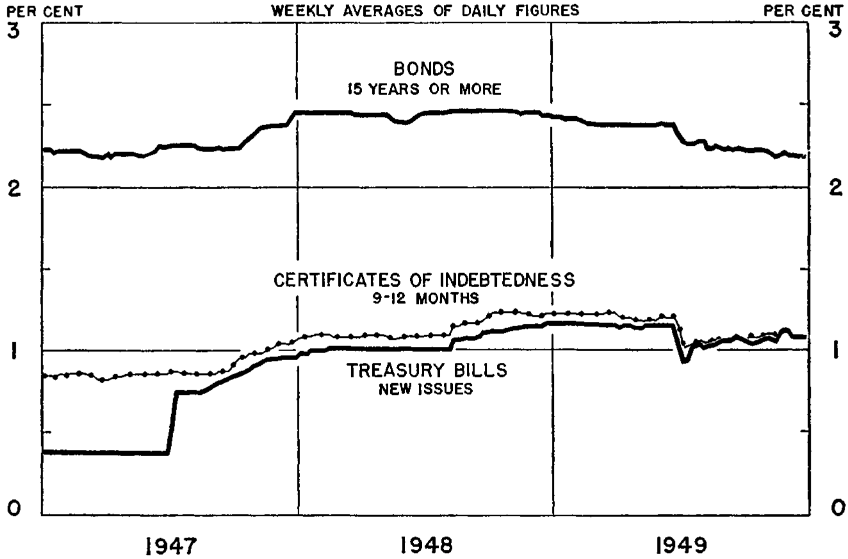
Throughout the first half of the year, the Federal Reserve sold Treasury bonds from the System portfolio in response to market demand, primarily from nonbank investors. These sales absorbed reserve funds released by seasonal declines in currency and deposits and a reduction in Treasury balances. As indicated earlier in the report, when the banks sought to purchase Government securities with reserves released by the reduction in reserve requirements early in May, the System made short-term securities available in order to prevent downward pressures on short-term money market rates.

On June 28, just before the further reduction in reserve requirements on June 30, the Federal Open Market Committee issued the following statement:

> The Federal Open Market Committee, after consultation with the Treasury, announced today that with a view to increasing the supply of funds available in the market to meet the needs of commerce, business, and agriculture it will be the policy of the Committee to direct purchases, sales, and exchanges of Government securities by the Federal Reserve Banks with primary regard to the general business and credit situation. The policy of maintaining orderly conditions in the Government security market, and the confidence of investors in Government bonds, will be continued. Under present conditions the maintenance of a relatively fixed pattern of rates has the undesirable effect of absorbing reserves from the market at a time when the availability of credit should be increased.

This policy announcement was soon followed by important developments in the Government securities market. When member banks sought to invest the reserves released on June 30 and July 1 in short- and medium-term Government securities, the Federal Reserve discontinued selling from the System account for a short period. Market prices and yields reacted sharply. Rates on Treasury bills fell within a few days from 1.16 per cent to below 1 per cent and, as shown in the chart, a similar drop occurred in yields on certificates. In order to restore more orderly conditions in the market, the Federal Reserve again made short-

YIELDS ON U. S. GOVERNMENT SECURITIES



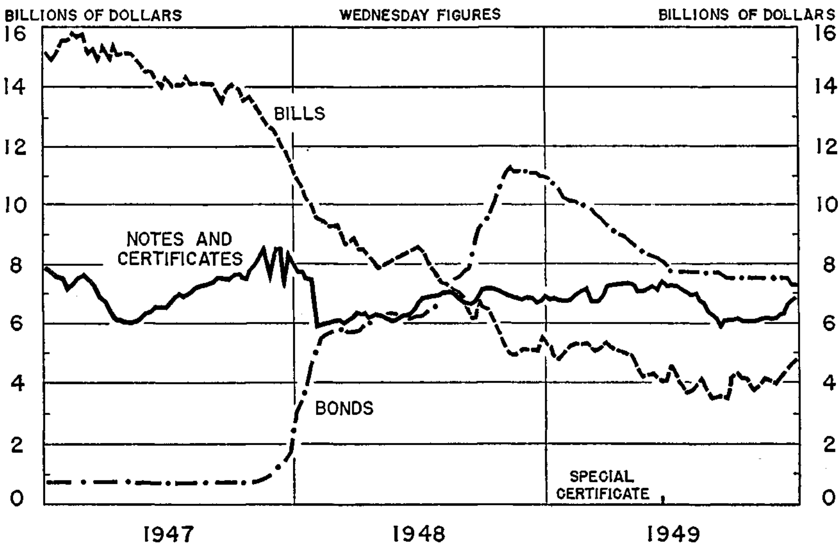
NOTE.—For Treasury bills, rate is average discount on new issue offered during week.

term securities available from its portfolio. Rates on short-term Government securities adjusted upward somewhat but remained below the levels that had prevailed before the end of June.

After this upward adjustment in yields, rates on new Treasury bills varied between 1.01 and 1.12 per cent through the close of the year, and yields on 9-12 month certificates in general moved at a slightly higher level and within a somewhat narrower range. The spread between the yield on longer term certificates and that on 3-month bills was generally narrower than had prevailed previously. At times when conditions in the money market were less easy and yields on bills and certificates were at or near the upper end of the yield ranges mentioned above, the System purchased short-term Government securities in order to meet temporary reserve needs of member banks. During periods when there were surplus funds in the short-term money market and yields declined to the lower area of these ranges, the System made Treasury bills and certificates available to the market, or allowed bills held in the System portfolio to be redeemed at maturity without replacement.

In line with this practice, the Federal Reserve made an additional supply of short-term Government securities available at prevailing market yields in August and early September when member bank reserve requirements were further reduced. As is indicated by the chart, liquid short-term investments were thus provided for any excess reserve funds that banks were unable to utilize elsewhere. The liquidity of member banks was thus greatly increased by the Board's action to reduce reserve requirements. As a result of this action and System sales of short-term securities, nonliquid required reserves were converted into liquid short-term earning assets. This development, together with the decline in yields on liquid types of investments that resulted primarily from the redirection of System open market policy, tended to make bank credit more readily available to private borrowers when their demand for credit increased in late summer.

RESERVE BANK HOLDINGS OF U.S. GOVERNMENT SECURITIES



Following the announcement of June 28, the Federal Reserve discontinued the practice of making Government bonds available in response to market demand. The purpose of this decision was to avoid absorbing funds that might otherwise be available for private borrowers. Market prices and yields on Government bonds reflected the interplay of private purchases and sales. The average yield on long-term Government bonds declined from 2.38 per cent for June to 2.24 per cent for August, and yields on medium-term securities declined even more sharply. Between August and the end of December, yields on long-term Government bonds moved within narrow ranges at levels comparable with those prevailing in late 1946 and the first nine months of 1947. Federal Reserve sales of Treasury bonds were negligible in the last half of 1949 compared with sales of about 3 billion dollars in the preceding six months.

Until the middle of November, Federal Reserve open market operations were carried on under the policy of monetary ease adopted early in the summer. At that time there was growing evidence that the recovery in economic activity would continue with increasing strength. In recognition of this change in conditions, the Federal Open Market Committee adopted a policy of permitting growing credit demands to be reflected in rising short-term rates. Treasury bill rates rose somewhat in November, but rates on certificates were held down until after Treasury refunding operations were completed on January 2. Early in 1950 the Federal Reserve sold securities, both short- and long-term, to absorb available reserves and to meet investor demands for securities. Accompanying this action yields on Government securities rose slightly and nonbank investors made substantial purchases of these securities from banks.

In June 1949, for the first time since 1945, the Federal Reserve System made advances direct to the Treasury for its temporary accommodation. The special short-term certificates of indebtedness thus acquired were held by the Reserve Banks on June 15 and 16. Federal Reserve Bank holdings of special short-term Treasury certificates during the years 1943-49 are shown in Table 4 on page 85.

Maintenance of discount rates. The Federal Reserve Banks maintained discount rates on eligible paper at 1½ per cent throughout the year 1949. Table 11 on page 94 shows the schedule of discount rates at the various Federal Reserve Banks on December 31, 1949.

Easing of consumer instalment credit terms. Other credit actions by the Federal Reserve initiated early in the year relaxed previously imposed restraints on particular types of lending—consumer instalment credit and stock market credit. Modification of these selective credit regulations began in March and consequently exerted an easing influence on credit terms in these areas during the greater part of the year.

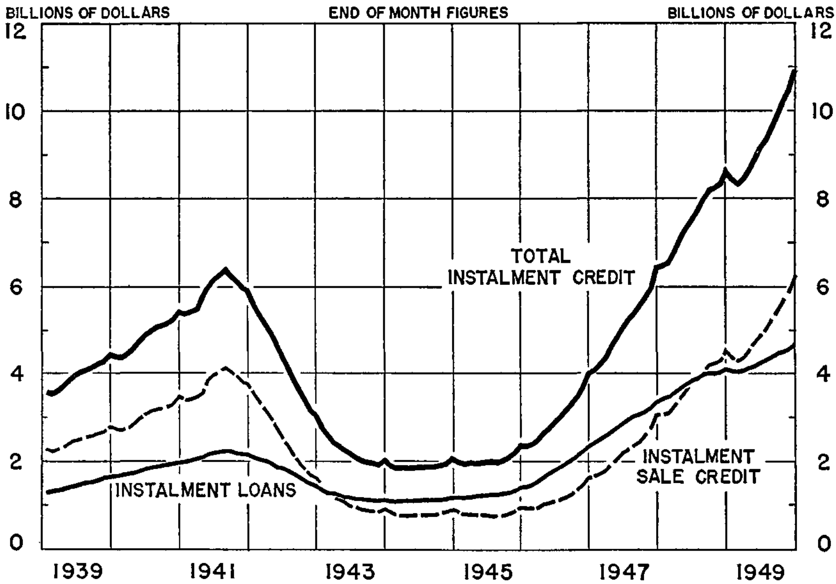
Under temporary authority granted by the Congress, effective September 20, 1948 the Board of Governors had reimposed controls over consumer instalment credit with the objective of curbing its rate of expansion. The maximum maturities and minimum down payments then prescribed were more lenient than those prevailing when the power had lapsed the preceding November. A substantial amount of discretion in setting the terms of instalment contracts was left to retailers and lenders.

Consumer buying pressures in this area had moderated significantly by the end of February 1949, and many of the commodities covered by the Board's Regulation W were in larger supply and in some cases at lower prices than formerly. Consumer instalment credit had been expanding less rapidly for several months, after having increased approximately fourfold from the abnormally low level reached during the war. In January and February the re-emergence of seasonal patterns—largely obscured during the period of rapid growth—brought the first month-to-month declines since 1945 in outstanding consumer instalment debt.

To meet this changed situation, and taking into account as well the downward readjustments occurring in the economy generally, the Board of Governors relaxed its regulation of consumer instalment credit terms effective March 7 and again effective April 27. These actions probably helped to prevent further decline of consumer expenditures for durable goods. Notwithstanding the fact that maturities and down payments specified in contracts for listed articles generally stayed well within the limits set by Regulation W, there was a noticeable easing of credit terms after each relaxation of requirements. A further easing of terms, which spread to all areas of instalment financing, followed termination of regulation on June 30, when the Board's temporary regulatory authority expired.

Expansion of instalment credit was resumed after February and was maintained throughout the remainder of the year, as is shown in the chart. Sales of automobiles continued at a rapid rate and in the second half of the year sales of furniture and other durable household goods increased. Instalment balances also rose sharply, not only because of larger sales but also because of smaller down payments and longer maturities under the easier terms.

CONSUMER INSTALMENT CREDIT



By the end of 1949, instalment credit was at a record total of almost 11 billion dollars. The expansion in the last half of the year, after temporary postwar regulation had been removed, averaged approximately 295 million dollars a month. The corresponding figure for the period December 1947-August 1948 inclusive, after the termination of wartime controls, was 220 million. While regulation was in effect during most of 1947 and again in the last few months of 1948, monthly average increases were much smaller—170 million and 137 million, respectively. The differences in growth reflected in some degree factors other than credit terms, but the presence or absence of regulation was important.

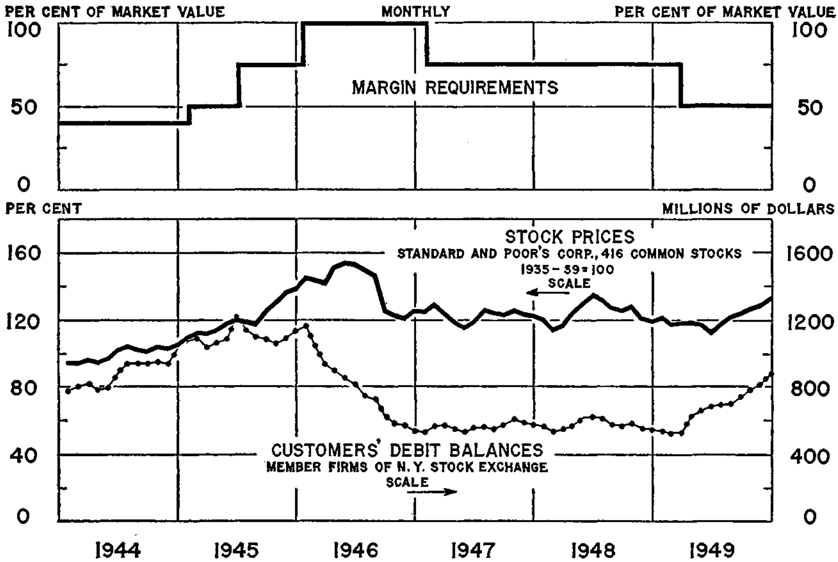
Regulation of this limited credit area may of itself exert only a small influence in behalf of economic stability. Experience with Regulation W has indicated, however, that it can be helpful in that direction and that the easing and removal of controls is followed by an easing of effective credit terms and an expansion of the amount of consumer instalment credit outstanding. Expansion was salutary during most of 1949, when the economy was in a phase of readjustment, and relaxation of general as well as selective credit controls was in order.

Reduction in margin requirements. Beginning in March 1949, the Board eased the regulations governing the use of credit in the securities markets. The volume of credit for purchasing or carrying securities had been substantially contracted under the relatively restrictive margin regulations of the postwar period. In February 1949 stock market credit outstanding was close to the lowest level on record. Owing partly to high margin requirements and to the public preference for holding liquid assets as against equity securities, the market was generally free of speculative tendencies. Easing of the Board's regulations in 1949 permitted somewhat more buying of stocks on credit and thus provided increased credit support for the expansion of equity financing.

Margin requirements under the Board's Regulations T and U were reduced, effective March 30, 1949, from 75 per cent to 50 per cent. The change restored the same required margin as that in effect from February to June of 1945, which was only moderately higher than the 40 per cent requirement effective during the period 1938-44. Effective May 16, 1949, the regulations were amended to permit a 25 per cent margin in the case of securities acquired through subscription rights when certain conditions are met. Other amendments, effective May 1 and July 20, 1949, relaxed or removed certain administrative provisions of the regulations.

Borrowing in margin accounts expanded substantially after margin requirements were reduced. The immediate increase in purchases of securities on credit came at a time when stock prices had been declining and therefore tended to have a stabilizing effect on the stock market. As shown by the chart, the amount owed by customers to member firms of the New York Stock Exchange increased sharply from March to June 1949 while common stock prices were declining to the lowest level since 1945.

MARGIN REQUIREMENTS AND THE STOCK MARKET



Stock market credit continued to expand in the second half of 1949. By the end of the year credit extended by brokers to their customers totaled 881 million dollars, the largest amount since the spring of 1946 though still well below the 1.2-1.5 billion dollars outstanding in the period 1933-37 and again in 1945. The downward movement of stock prices was reversed in June and prices rose steadily thereafter. By the end of the year, common stock prices had reached a level close to the peak of the preceding two years; by May 1950 they were close to the 1946 peak, which was the highest level since 1930. Participation of the public in the stock market, which had been relatively small in the first eight months of 1949, increased somewhat in the last four months of that year and in the early months of 1950.

BANKING AND MONETARY DEVELOPMENTS IN 1949

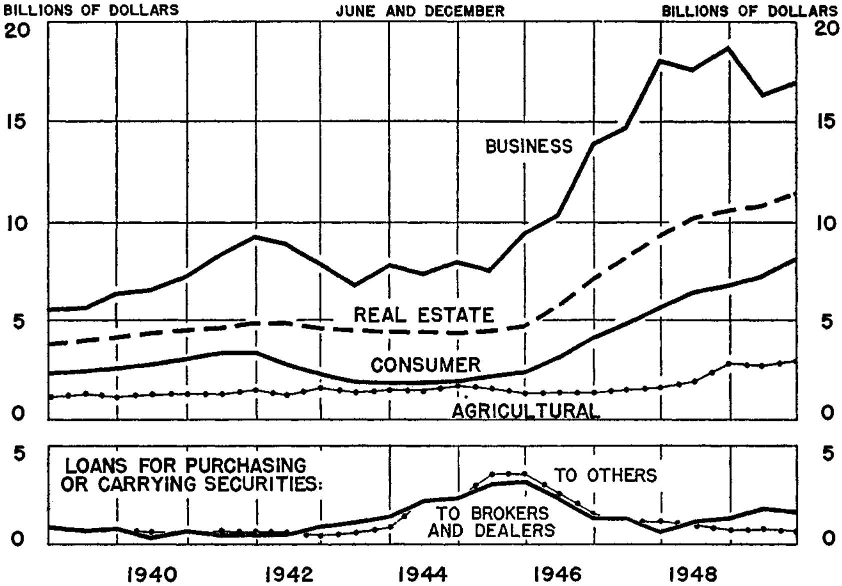
Bank credit to private borrowers declined until midsummer 1949 and then increased substantially during the remainder of the year. The currency and deposits of individuals and businesses declined sharply in the first quarter of the year and increased steadily thereafter to almost 170 billion dollars at the end of the year. This exceeded the year-end figure for 1948 by about 700 million dollars but was slightly below the peak reached at the end of 1947.

Bank lending activity. Sharp contraction of business borrowing at commercial banks in the first half of 1949 was followed by rapid expansion beginning in August. At year-end business loans at insured commercial banks were about 1.8 billion dollars below the level of a year earlier but about 1.0 billion above the year's low in early August. The rate of growth in other major types of bank loans slowed down in the early part of the year and then increased again, but for the year as a whole the aggregate increase was considerably less than that of 1948. The decline for the year in loans to commerce and industry was more than offset by increases in loans to farmers (nearly 200 million dollars), to real estate owners (700 million), and to consumers (1.2 billion dollars). Loans for purchasing and carrying securities also increased (300 million dollars). As a result total loans at insured commercial banks increased by more than 500 million dollars in 1949 to a new peak of 42.5 billion. Loans at mutual savings banks, largely real estate mortgages, increased by 900 million dollars, the largest growth in recent years.

Business borrowing at insured commercial banks declined about 2.5 billion dollars from December 31, 1948 to June 30, 1949, as is shown in the chart. This decline, most of which came after March, was considerably greater than the amount normally attributable to seasonal factors. It undoubtedly reflected in part the high level of business profits and retained earnings in late 1948, as well as some curtailment and postponement of business capital expenditures, liquidation of inventories, and reduction in other working capital requirements. In addition, businesses paid off large amounts of bank credit with proceeds of security flotations, including both public offerings in the market and private placements with insurance companies.

Beginning in August, the decline in bank loans to business gave way to expansion, reflecting both seasonal needs for working capital and more than the usual seasonal rise in production. Between then and the end of the year the expansion totaled

LOANS OF COMMERCIAL BANKS
ALL INSURED BANKS



NOTE.—All insured commercial banks in the United States. Business loans include commercial and industrial loans, open market commercial paper, and acceptances. Consumer loans are partly estimated prior to Dec. 31, 1942.

about 1 billion dollars, somewhat more than in the corresponding period of 1948.

Consumer instalment credit extended by banks and other lenders contracted somewhat in January and February, for the most part seasonally. Expansion was resumed in March and accelerated in the late summer and fall. In the last half of the year, monthly growth in consumer instalment indebtedness averaged approximately 295 million dollars compared with about 230 million in the second quarter. The growth was more marked in automobile sale credit outstanding than in other instalment segments but all reached new highs by the end of the year. Total instalment indebtedness increased by 2.3 billion dollars during 1949 to an estimated 10.9 billion on December 31.

Real estate lending was in smaller volume during the first half of 1949 than in the corresponding period of earlier postwar years, but it increased rapidly in the second half of the year when residential building rose sharply. For the year as a whole, mortgage lending continued at about the same high level as in 1948 and 1947. The increase in outstanding mortgage debt slowed down, however, because debt retirement was greater in 1949 than in the earlier years. Holdings of real estate loans increased considerably less at commercial banks than at savings and loan associations, life insurance companies, or savings banks.

During the second half of 1949, when mortgage loans held by banks and other institutional lenders increased substantially, mortgage portfolios at insured commercial banks expanded by about half a billion dollars. This increase was about the same as in the corresponding period of 1948 and about double that in the first half of 1949. Savings and loan associations and savings banks also increased their mortgage holdings at a faster rate during the second than the first half of 1949, but this was not generally true of insurance companies.

The reductions in member bank reserve requirements, particularly at mid-1949 and thereafter, and the decline in yields on United States Government securities, reacted favorably on the market for securities of State and local governments. These issues became relatively more attractive outlets for investment funds. Insured commercial banks increased their holdings about 650 million dollars in the last half of the year.

Bank credit for purchasing and carrying listed stocks increased moderately after the Board of Governors relaxed margin requirements in March. There were wide fluctuations in loans to dealers in Government securities, which were in large part related to the refinancing of maturing issues.

Availability of bank reserves. The principal factor influencing member bank reserve positions in 1949 was the series of reductions in reserve requirements described earlier in this report. Additional reserves were also made available to banks by the return of currency from circulation and a small gold inflow, as shown in the table and in the chart on page 20.

In the first quarter of 1949 banks obtained reserve funds primarily from a return flow of currency, and some existing reserves were freed by a decline in deposits subject to reserve requirements. These funds, however, were not sufficient to meet a drain on reserves that resulted from Treasury cash transactions and purchases by non-bank investors of long-term Government securities made available

MAJOR FACTORS AFFECTING MEMBER BANK RESERVES

[In billions of dollars]

Factor	1949					1948
	First quarter	Second quarter	Third quarter	Fourth quarter	Year	
Factors affecting total reserves:[1]						
Gold inflow	+0.1	+0.2	+0.1	−0.2	+0.2	+1.5
Return of currency from circulation	+0.8	−0.1	+0.1	−0.2	+0.6	+0.6
Treasury cash transactions [2]	−1.4	+0.9	−0.7	+0.4	−0.9	−5.7
Federal Reserve purchases (+) or sales (−) of U. S. Govt. securities in the open market, net [3]	−0.6	−2.2	−1.3	+0.9	−3.3	+6.3
Other factors, net	−0.3	−0.1	−0.1	−0.3	−0.5	−0.1
Changes in member bank reserves:						
Total reserves	−1.4	−1.3	−1.9	+0.6	−3.9	+2.6
Excess reserves	−0.5	+0.3	−0.2	+0.2	−0.2	−0.3
Required reserves	−0.8	−1.5	−1.7	+0.4	−3.7	+2.9
Factors affecting required reserves:						
Board action on reserve requirements [4]	....	−1.6	−2.2	....	−3.8	+3.0
Deposit changes [4]	−0.8	+0.1	+0.5	+0.4	+0.1	−0.1

[1] Signs preceding figures in columns indicate effect on total bank reserves.

[2] Changes in Treasury deposits at the Reserve Banks after adjustment for withdrawals resulting from retirement of U. S. Government securities held by the Reserve Banks.

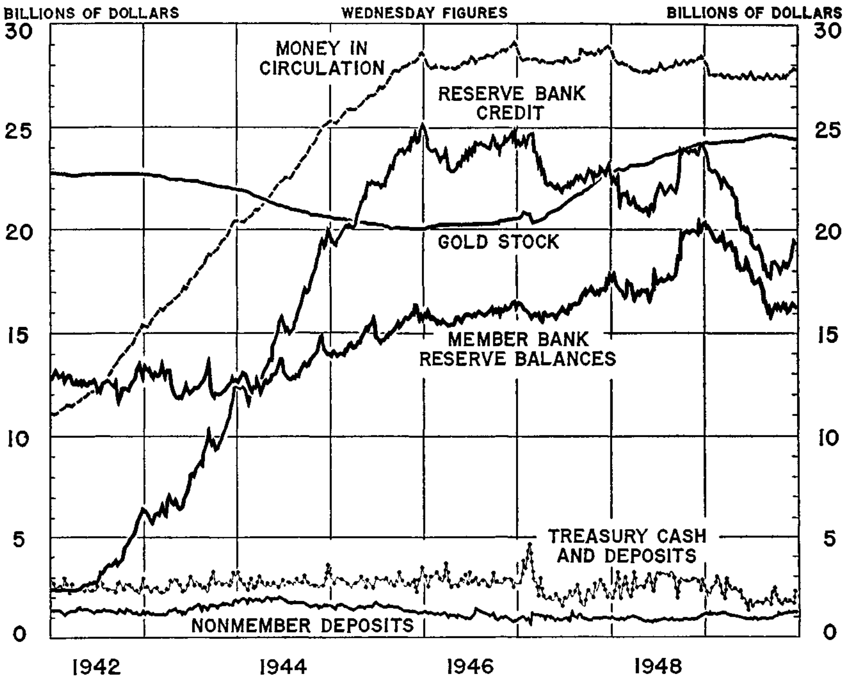
[3] Figures for market sales include decreases in Federal Reserve holdings of maturing Treasury bills resulting from incomplete exchanges of maturing issues for new issues.

[4] Signs preceding figures in columns indicate effect on required reserves.

NOTE.—Changes are based on figures for Dec. 31, 1947, Dec. 31, 1948, Mar. 31, 1949, June 30, 1949, Sept. 30, 1949, and Dec. 31, 1949. Figures may not add to totals because of rounding.

by the Federal Reserve Banks. Banks sold short-term Government securities in the market, some of which were purchased for the System account.

MEMBER BANK RESERVES AND RELATED ITEMS



In the second quarter reductions in reserve requirements and a net payment of funds out of Treasury deposits at Reserve Banks into private accounts held at commercial banks made available a substantial amount of reserve funds. These were used to purchase short-term Government securities, which came directly or indirectly from the Federal Reserve System portfolio. In the third quarter additional reserves were freed by further reductions in reserve requirements. These were more than sufficient to meet a temporary drain on bank reserves from Treasury cash transactions and to supply the additional reserves needed to cover the increase in deposits that resulted from a renewed expansion of bank loans. Other freed reserves were absorbed by Federal Reserve sales of Government securities which were largely purchased by banks. During the last quarter of the year Treasury operations and market purchases of Government securities by the Federal Reserve supplied banks with more than enough reserve funds to offset an outflow of gold and a seasonal increase of currency in circulation.

By the end of the year total member bank reserves were nearly 4 billion dollars smaller than at the beginning, reflecting the combined effect of the reductions in reserve requirements and the redirection of System open market policy. Member bank holdings of cash, excess reserves, and short-term Government securities increased almost 5 billion dollars between the end of April, when the first reduction in reserve requirements was announced, and the end of September, after the last reduction, as is shown in the table below. The increase was almost entirely in short-term Government securities, made available in substantial part by the Federal Reserve and purchased with funds released by reductions in reserve requirements.

During this period yields on liquid types of investments, primarily short-term Government securities, declined somewhat. Accordingly, banks not only had more funds for lending but found the holding of highly liquid assets to be less profitable than it had

MEMBER BANK HOLDINGS OF CASH, EXCESS RESERVES, AND SHORT-TERM GOVERNMENT SECURITIES

[Partly estimated, in billions of dollars]

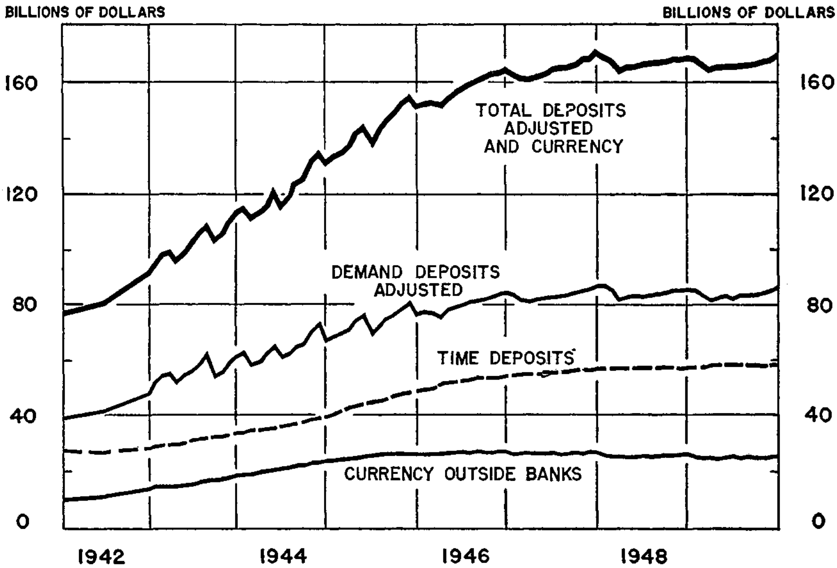
Asset	Amount held			Change Apr. 27–Sept. 28	Change Apr. 27–Dec. 31
	Apr. 27, 1949	Sept. 28, 1949	Dec. 31, 1949		
Total	12.3	17.1	16.3	+4.8	+4.0
Cash in vault	1.7	1.7	1.5	....	−0.2
Excess reserves	0.5	0.9	1.0	+0.4	+0.5
Treasury bills and certificates	10.1	14.5	13.8	[1] +4.4	[1] +3.7
Required reserves	18.5	15.1	15.6	−3.4	−2.9

[1] About 1 billion dollars of this increase was due to refunding.

been early in the spring. These developments tended to promote greater availability of credit to private borrowers and to State and local governments.

Changes in the money supply. The total of currency outside banks plus demand and time deposits, adjusted to exclude United States Government and interbank deposits and cash items in process of collection, declined by about 5 billion dollars in the first quarter of the year and thereafter increased by more than 5.5 billion, as is shown on the chart. The year-end total was slightly below the peak level at the end of 1947. Expansion of the money supply in the last quarter of 1949 amounted to 3.5 billion dollars and was much greater than in the corresponding period of 1948.

BANK DEPOSITS AND CURRENCY



NOTE.—Figures are partly estimated. Deposits are for all banks in the United States. Demand deposits adjusted exclude U. S. Government and interbank deposits and items in process of collection. Time deposits include deposits in the Postal Savings System and in mutual savings banks. Figures are for June and December, 1942; end of month, 1943-46; last Wednesday of month, 1947-49 except for June and December call dates.

The amount of currency outside banks declined in 1949 for the third successive year. At the end of the year it was 700 million dollars less than a year earlier and 1.3 billion dollars less than in December 1946. The total of 25 billion dollars was still more than three times the amount outstanding at the end of 1940. The return of currency from circulation since 1946 has been primarily in bills of $10 and $20 denominations, but in 1948 and 1949 there was some return of bills of $50 denomination or larger.

Privately owned demand deposits in 1949, as in 1948, declined during the first quarter and expanded during the remainder of the year. The decline in the first quarter, when tax payments were heavy, was not as large as in 1948, and the expansion in the last months of the year was somewhat larger than in 1948. The volume of privately owned demand deposits was slightly larger at the end of 1949 than at the end of 1948.

Time deposits increased further in 1949. As in 1948, the growth amounted to about 1 billion dollars and occurred almost entirely in the first half of the year. Mutual savings banks, which are important in the northeastern part of the country, accounted for most of the expansion. Liquid assets held by individuals and businesses in the form of United States Government securities and of shares in savings and loan associations also increased during the year.

In 1949, both the expansive and the contractive forces affecting the money supply held by individuals and businesses were moderate, in contrast with 1948, when a small net decline reflected a balancing of large movements in various factors. For 1949 as a whole expansion of the money supply through growth in bank loans was small in comparison with 1948. The total increase in bank credit to borrowers other than the United States Government, including both loans and investments, was only about 2.6 billion dollars, as compared with 5.9 billion in the preceding year. Gold inflow was moderate during the first three quarters of 1949, and there was a small outflow following currency devaluations by many foreign countries beginning in September. The net gold inflow for the year as a whole amounted to one-eighth of that in 1948. Market transactions in Government securities by nonbank investors had little net effect on the money supply in either 1948 or 1949.

Treasury transactions were the principal factor contracting the private money supply in both years. In 1949 the Treasury increased its cash balance somewhat and its cash retirements of bank-held Government securities exceeded its cash sales of new issues to banks by nearly 1 billion dollars. The contractive influences of Treasury transactions were felt in the first quarter when income tax and other receipts exceeded expenditures considerably, and again in the third quarter of the year, when sales of savings notes were exceptionally heavy. During other periods of the year Treasury operations tended to increase rather than reduce private holdings of money. The magnitudes of these factors are given in the accompanying table.

MAJOR FACTORS AFFECTING DEPOSITS AND CURRENCY

[In billions of dollars, partly estimated]

Factor	1949					1948
	First quarter	Second quarter	Third quarter	Fourth quarter	Year	
Factors affecting deposits and currency:[1]						
Gold inflow	+0.1	+0.2	+0.1	−0.2	+0.2	+1.5
Loans—commercial and mutual savings banks	([2])	−1.1	+0.9	+1.6	+1.4	+5.2
Securities of State and local governments and corporations held by commercial and mutual savings banks	+0.1	+0.4	+0.7	([2])	+1.2	+0.7
Treasury deposits, decrease (+) or increase (−)	−1.5	+2.3	−2.1	+0.8	−0.5	−1.3
Treasury sale (+) of new U.S. Govt. securities to, or retirement (−) of maturing securities held by, banking system,[3] net	−1.4	−0.2	+0.8	−0.1	−0.9	−5.9
Market purchases (+) or sales (−) of U. S. Govt. securities by the banking system, net	−2.0	+0.3	+1.3	+1.1	+0.7	−0.1
Other factors, net	−0.2	−0.5	−1.0	+0.3	−1.4	−1.0
Changes in deposits and currency held by individuals and businesses:						
Total	−4.9	+1.4	+0.7	+3.5	+0.7	−0.9
Demand deposits adjusted	−4.4	+0.8	+1.2	+2.7	+0.2	−1.6
Time deposits[4]	+0.5	+0.5	−0.1	+0.2	+1.1	+1.1
Currency outside banks	−1.0	+0.2	−0.4	+0.5	−0.7	−0.4

[1] Signs preceding figures in columns indicate effect on deposits and currency.
[2] Less than 50 million dollars.
[3] Includes commercial banks, mutual savings banks, and Federal Reserve Banks.
[4] Includes changes in deposits at commercial banks, mutual savings banks, and the Postal Savings System.

NOTE.—Except for transactions in U. S. Government securities, which are for end-of-quarter dates, changes are based on figures for Dec. 31, 1947, Dec. 31, 1948, Mar. 30, 1949, June 30, 1949, Sept. 28, 1949, and Dec. 31, 1949. Figures may not add to totals because of rounding.

Regional changes in deposits. There were no striking changes during 1949 in the regional distribution of deposits. The absence of a pronounced general movement of funds among major areas of the country in 1949 is in sharp contrast with the situation during the war and in the early postwar period. In those years funds were flowing into the southern and western areas, and deposits expanded considerably more rapidly at banks in these sectors of the country than elsewhere. Also, deposits at country banks generally increased more than those at city banks. These movements, which had continued through 1948, appear to have been reversed slightly in 1949. The change from the early postwar period probably reflects among other things a change in the relationships between agricultural and industrial prices.

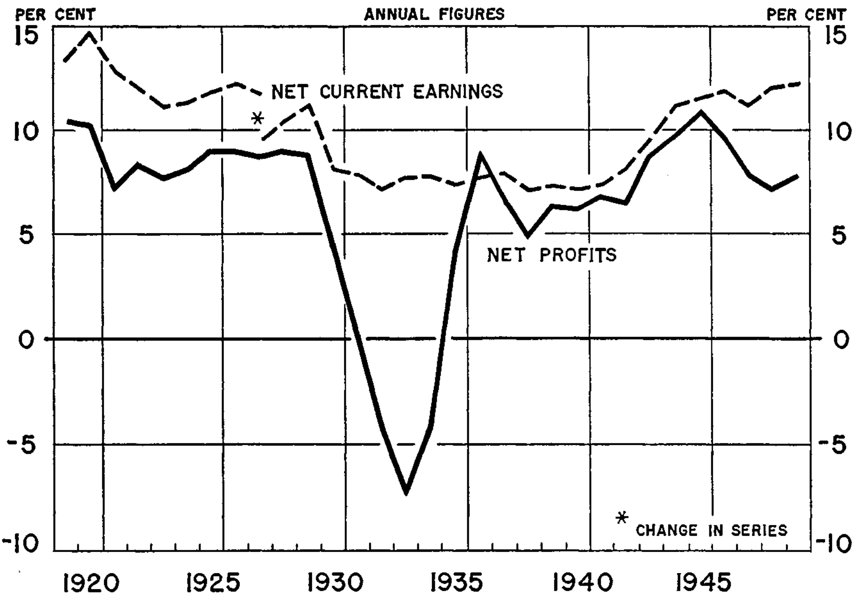
Bank earnings and profits. In 1949 net current earnings of member banks before income taxes continued their upward trend of recent years, advancing to 1,097 million dollars, an increase of 64 million over 1948. Increases of 119 million in earnings on loans and of 38 million in other earnings more than offset an increase of 94 million in operating expenses. A small increase in earnings from United States Government securities reversed the downward trend of 1947 and 1948.

Net profits (after adjustments for losses, recoveries, profits on securities, valuation reserves, and income taxes) amounted to 686 million dollars, 65 million more than in 1948. This increase reflected higher net current earnings, smaller additions to valuation reserves, and larger net profits and recoveries on securities; these were offset in part by larger income taxes and losses on loans. Transfers to valuation reserves, which amounted to 172 million dollars in 1949, have become an important factor in the interpretation of reported bank profits. When transfers exceed losses charged against the reserves, as they have in the past three years, there is a decline of reported net profits in relation to net current earnings. However, when the losses exceed the transfers, the reserves will help maintain the level of profits. All classes of banks except central reserve city banks in New York City reported increases in net profits. The decline at New York City banks reflected mainly larger net transfers to valuation reserves and increased provisions for income taxes.

Approximately 313 million dollars, or 46 per cent of net profits of member banks in 1949, was paid out as dividends, compared with 47 per cent in 1948. The rate of dividend payments on total capital accounts was 3.5 per cent in 1949, up slightly from the year before.

Net profits of member banks were 7.6 per cent of average total capital accounts as compared with 7.2 per cent in 1948. This was the first increase since 1945, when profits on securities sold or redeemed were very high and the net profits ratio reached the peak of 10.9 per cent. The ratio of net current earnings to average total capital accounts increased slightly from 12.0 per cent in 1948 to 12.2 per cent in 1949. As indicated on the accompanying chart,

EARNINGS RATIOS OF MEMBER BANKS
PERCENTAGES OF CAPITAL ACCOUNTS



NOTE.—Net current earnings are total earnings from current operations less current operating expenses. Net profits are net current earnings after adjustments for losses, recoveries, profits on securities, transfers to and from reserves, and taxes on net income. Capital accounts consist of all forms of capital, including capital notes and debentures, surplus, undivided profits, reserves for contingencies, and other miscellaneous capital accounts. Prior to 1927 profits on securities were included in current earnings; beginning in 1942 taxes on net income were excluded, while recurring depreciation was included, as a current operating expense deduction from earnings. Capital figures are averages of June and December call-date figures 1919-40, of three or four call-date figures 1941-48, and of three call-date and 10 intervening last-Wednesday-of-the-month figures for 1949.

this approximates the high level of the 1920's and is considerably above the level of the 1930's. In contrast, and largely because of the relatively greater growth in assets than in capital, the ratio of net current earnings before income taxes to total assets was 0.85 per cent in 1949 and 0.79 per cent in 1948, considerably below the level of the 1920's and early 1930's.

Bank earning assets. Earning assets of member banks at the end of 1949 were 6 billion dollars more than at the end of 1948 and approximated 102 billion; a 5 billion dollar increase in holdings of United States Government securities accounted for most of the increase. However, average holdings and the rate of earnings on Government securities during 1949 were practically unchanged from 1948 and resulted in an increase of only 4 million dollars in earnings from this source.

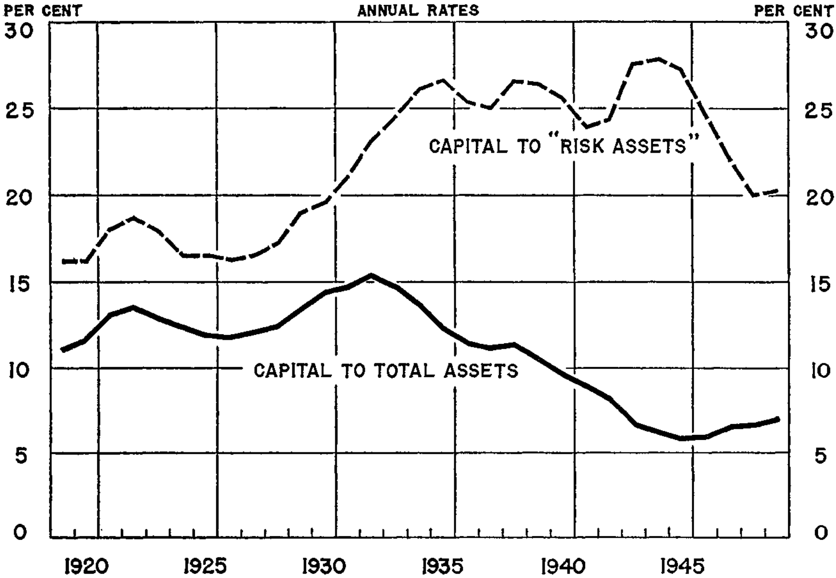
Although loan holdings at the year-end showed an increase of 170 million dollars over a year ago, average holdings for the year were considerably higher. During the year there were some important shifts in the types of loans held. Commercial and industrial loans declined for the first time since 1942. This decline was largely offset, however, by increases in real estate and consumer loans. The shift toward loans with higher yields and rate advances for some categories of loans increased the rate of earnings on loans from 3.83 per cent in 1948 to 4.05 per cent in 1949. The higher rates, together with larger average holdings for the year, brought earnings on loans for 1949 to 1,427 million dollars, up 119 million from 1948.

Holdings of securities other than United States Government obligations continued to increase and amounted to more than 8 billion dollars at the end of 1949, approximately a billion higher than at the end of 1948.

Capital accounts. Capital accounts of member banks amounted to 9,174 million dollars on December 31, 1949, an increase of 373 million over the previous year. Retention of profits accounted for the increase. The percentage of net profits retained rose slightly to 54 as compared with 53 in 1948. Sales of additional common stock amounting to about 37 million dollars were largely offset by retirements of preferred stock and capital notes amounting to 10 million and by capital repayments to stockholders incident to mergers.

As indicated on the accompanying chart, the ratio of average total capital accounts to average total assets increased from 6.6 to 7.0 per cent in 1949. The ratio of average total capital accounts to average "risk assets" (total assets less Government securities and cash assets) also increased slightly, in contrast to declines in other recent years.

CAPITAL RATIOS OF MEMBER BANKS
PERCENTAGES OF TOTAL ASSETS AND "RISK ASSETS"



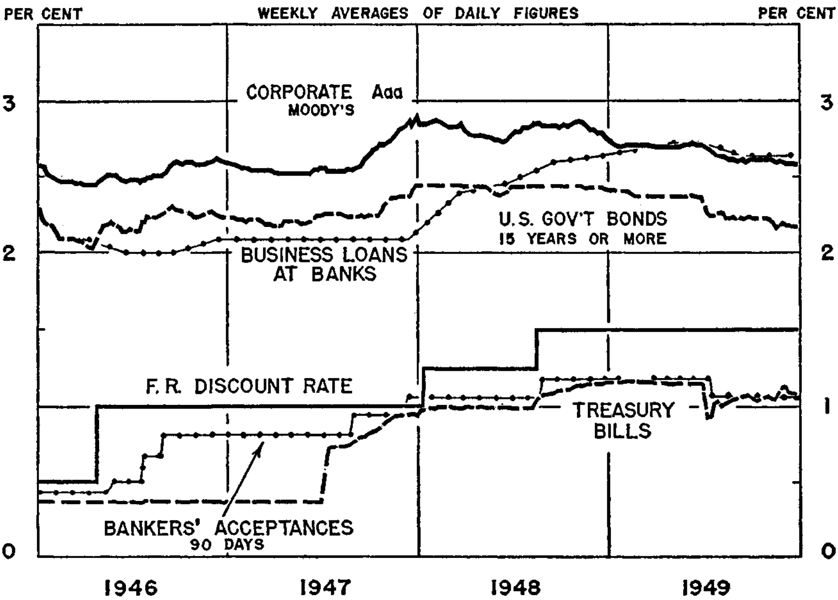
NOTE.—"Risk assets" represent total assets other than cash assets and U. S. Government securities. Capital and asset figures are averages of June and December call-date figures 1919-40, of three or four call-date figures 1941-48, and of three call-date and 10 intervening last-Wednesday-of-the-month figures for 1949.

INTEREST RATES

Financial policies of business enterprises, investment demand, and the open market policy of the Federal Reserve System greatly influenced the level and structure of interest rates in 1949. In general, both long- and short-term rates were fairly stable during the first six months of the year and declined thereafter. Bond yields declined rapidly in July and August and more gradually throughout the remainder of the year. Short-term rates dropped abruptly in late June and early July and subsequently fluctuated within a narrow band.

Yields on United States Government securities. For the year as a whole, there was some decline in the yields on all maturities of United States Government securities. Longer term and short-term yields changed little in the first half of the year and subsequently declined, as is indicated by the chart. Yields on medium-term securities eligible for bank purchase, however, at midyear were considerably below first-of-year levels.

MONEY RATES



NOTE.—For Treasury bills, rate is average discount on new issue during week. Federal Reserve discount rate is for the Federal Reserve Bank of New York. Rate on business loans at banks is average for loans made at banks in 19 selected cities in the first 15 days of March, June, September, and December. Rate on bankers' acceptances is weekly prevailing rate.

In the first half of the year the repayment of commercial loans reduced bank deposits and released reserves which, together with reserves freed by a reduction in reserve requirements early in May, were used largely to purchase short- and medium-term United States Government securities. The Federal Reserve System made some of these maturities available during this period. Rates on short-term issues were maintained but yields on medium-term securities declined considerably. Through midyear, rates on one-year Treasury certificates continued at about 1¼ per cent and average yields on new issues of Treasury bills held close to 1.16 per cent.

Following the statement of the Federal Open Market Committee on June 28 and reduction in reserve requirements, yields on short-term Government securities fell abruptly. The decline was arrested and partly reversed, however, by the sale of bills and certificates by the Federal Reserve and by the redemption of bills from the System portfolio. Throughout the remainder of the year the System bought and sold bills and certificates in order to supply banks with reserves needed to meet current demands for credit and currency, but at the same time to moderate movements in bank reserves and hence in short-term money rates. Yields of certificates and of bills moved closer together, as is shown in the chart on page 9, and there was some narrowing of the spread between short-term and long-term rates. At the year-end, rates on both one-year certificates and Treasury bills were about 1⅛ per cent, compared with nearly 1¼ per cent for certificates and about 1.16 for bills at the beginning of the year.

Average yields on long-term Treasury bonds declined by a fourth of 1 per cent during the year. During the first half of 1949 there was a substantial demand by savings banks and private pension and trust funds for long-term Government securities, arising partly from an inflow of funds and partly from shifts out of medium-term Government security holdings. This was met largely by sales of securities from the Federal Reserve portfolio. In these circumstances, the decline in average yield of taxable Government bonds with a maturity of 15 years or more was moderate—from 2.44 per cent in December 1948 to 2.38 per cent in March 1949. This yield was maintained until the decline in yields on all maturities of Government securities after June 28. Thereafter the average yield on long-term bonds declined gradually until it reached 2.19 per cent in December.

Corporate and State and local government bond yields. A record half-year volume of new corporate security issues, coupled with the competition of long-term Government securities, maintained yields on corporate bonds during the first half of 1949. After a decline in 1948, average yields of Aaa corporate bonds remained at about 2.71 per cent until July 1949, as is shown in the chart on page 29. There was very little change in the spreads between yields on this and other grades of corporate bonds.

In the second half of the year, however, yields on corporate securities declined, reflecting the decline in yields on United States Government bonds and the substantial decline in new corporate security offerings. The average yield on high-grade corporate bonds fell from 2.71 per cent in June to 2.58 per cent in December. The spreads among the various grades of corporate bonds had narrowed slightly by the end of the year.

Yields on securities sold by State and local governments to finance their expanding construction and capital improvement programs increased somewhat in the late spring and early summer, mainly because of the heavy volume of new issues, and some important issues were postponed awaiting more favorable terms. Yields on these securities declined during the last half of the year notwithstanding a continuing large volume of new issues.

Short-term commercial rates. Average rates on short-term commercial loans by banks, which had increased somewhat in 1948, changed little during 1949. They advanced slightly from an average of 2.64 per cent in December 1948 to 2.74 per cent in June 1949, notwithstanding the decline in bank credit. In the third quarter of the year, however, the average declined to 2.63 per cent and remained essentially unchanged in the fourth quarter. The changes were less pronounced in New York City than in other cities.

Other short-term rates, both open market rates and customer rates, remained stable over the first half of the year and declined after June in adjustment to the lower yields of short-term Government issues. Offering rates on prime 90-day bankers' acceptances, for example, were marked down from 1$\frac{3}{16}$ to 1$\frac{1}{16}$ per cent on July 5, corresponding roughly with the reduction in Treasury bill yields. Late in the year acceptance yields were below those of Treasury bills for the first time since 1937.

TREASURY FINANCING

A Treasury cash deficit of 1.3 billion dollars in the calendar year 1949 contrasted sharply with substantial surpluses in each of the two preceding years. Cash income exceeded cash outlays in the first quarter of the year, when income tax payments were heavy, but this surplus was more than offset by the deficit incurred during the remaining three quarters of the year. Funds acquired through cash borrowing exceeded the deficit and provided a small increase in the Treasury cash balance.

As a result primarily of such borrowing, but also through the accrual of interest on savings bonds and notes, United States Government securities held by the public increased 2.3 billion dollars in 1949 and amounted to 218 billion by the year-end. The Treasury also issued about 2 billion dollars of special securities for investment of money accumulated by Federal agencies and trust funds. The total United States Government debt of all forms, including securi-

TREASURY CASH OPERATIONS AND UNITED STATES GOVERNMENT DEBT HELD BY THE PUBLIC

[In billions of dollars]

Item	Calendar year		
	1949	1948	1947
Cash operating income [1]	41.4	45.0	44.3
Cash operating outgo [1]	42.6	36.9	38.6
Net cash surplus (+) or deficit (−)	−1.3	+8.1	+5.7
Change in Treasury cash balance	+0.5	+1.1	[2] −2.2
Change in debt held by the public:			
Net cash borrowing (+)[3]	+1.7	−7.0	−7.9
Accrual of interest on debt, etc. (+)[4]	+0.5	−0.1	+2.0
Change in total held by the public	+2.3	−7.1	−5.9
Debt held by the public, end of period [5]	217.8	215.5	222.6

[1] The cash budget differs from the Budget based on the Treasury's daily statement principally in that it includes transactions of Federal agencies and trust funds and excludes major intragovernmental transactions and noncash transactions with the public.

[2] Includes also a decrease of 1.8 billion dollars in the Exchange Stabilization Fund in part payment of the United States contribution to the International Monetary Fund.

[3] Includes principally net changes in marketable debt adjusted to reflect net market sales or purchases of marketable issues by Government agencies and trust funds, and net sales or redemptions of savings bonds and savings notes.

[4] Includes principally net accrued interest on savings bonds and Treasury bills, and amounts of Federal securities issued in payment of certain budget expenditures, such as armed forces leave bonds. Includes also small adjustment to exclude changes in nonguaranteed debt and in holdings of the Postal Savings System.

[5] Excludes securities held by U. S. Government agencies and trust funds. Includes guaranteed debt.

ties held by the public and by Federal agencies and trust funds, amounted to 257 billion dollars on December 31, 1949. This was about 4 billion dollars more than the total on December 31 of the previous year.

Cash deficit. The shift in the Federal Government's financial position from a large surplus in 1948 to a deficit in 1949 resulted mainly from an expansion of cash outlays, and to a lesser extent from a decline in cash income. Total outlays in 1949 amounted to 42.6 billion dollars, 5.7 billion more than in the previous year. Expenditures on national defense and international finance and aid increased by about 2 billion dollars, and outlays by the Commodity Credit Corporation, the Reconstruction Finance Corporation, and the Unemployment Trust Fund also increased. Payments of veterans' allowances and benefits declined somewhat.

Treasury cash income declined by 3.6 billion dollars. As a result of a decline in personal income in 1949, together with a reduction in tax rates in mid-1948, personal income tax collections declined by 2.4 billion dollars and tax refunds rose by more than half a billion. Receipts from sales of surplus property were substantially lower than in 1948. There was a partly offsetting rise of nearly 1 billion dollars in receipts from the tax on corporate profits, reflecting the high level of corporate earnings in 1948.

Composition of debt. Continuing the trend of the previous three years, the total volume of marketable United States Government securities held by the public declined during 1949, but holdings of nonmarketable issues increased by a more than offsetting amount. The reduction in marketable securities reflected the fact that no new marketable securities except Treasury bills were offered for cash while a small portion of each maturing issue was redeemed for cash rather than refunded. In the first quarter of the year there were also small retirements of maturing securities held by the Reserve Banks.

The volume of Treasury bills outstanding showed almost no net change for the year, retirements during the first half having been offset by increased offerings in the second half. Treasury bonds called for redemption amounted to 6.6 billion dollars, of which 6.3 billion were refunded into certificates and notes, and the remainder was paid off in cash. A substantial portion—about 4.2 billion dollars—of bonds called for redemption was refunded into 4¼-year notes issued in December. These notes are the longest term marketable securities that have been offered since the Victory Loan Drive of 1945. Previously all maturing marketable securities that were not paid off in cash were refunded into short-term securities. Short-term notes and certificates issued in exchange for bonds amounted to 2.1 billion dollars. This expansion was more than offset, however, by cash retirements amounting to 2.1 billion dollars and the refunding of half a billion dollars of maturing certificates with the 4¼-year notes issued in December.

UNITED STATES GOVERNMENT DEBT HELD BY THE PUBLIC AT END OF 1949, BY TYPE OF ISSUE

[In billions of dollars]

Type of issue	December 31, 1949	Change during		
		1949	1948	1947
Debt held by the public, total [1]	**217.8**	**+2.3**	**−7.1**	**−5.9**
Marketable issues, total [2]	**149.8**	**−2.2**	**−8.5**	**−9.8**
Bills	12.3	+0.2	−3.0	−1.9
Certificates and notes	37.8	+4.2	+1.1	−7.4
Bonds	99.7	−6.6	−6.6	−0.5
Nonmarketable public issues, total	**65.9**	**+4.6**	**+1.9**	**+2.7**
Savings bonds	56.7	+1.7	+3.0	+2.3
Savings and tax notes	7.6	+3.0	−0.8	−0.3
Other	1.6	−0.1	−0.3	+0.8
Debt bearing no interest	**2.1**	**−0.1**	**−0.5**	**+1.2**
Detail on marketable issues, due or callable:				
Within 1 year	56.3	+7.4	−1.7	−4.2
1–5 years	34.9	−8.9	−5.8	+10.6
5 years and over, total	58.7	−0.7	−1.0	−16.2
Bank-eligible bonds	13.6	−0.5	−0.7	−17.1
Restricted bonds	45.1	−0.1	−0.3	+0.9

[1] Excludes securities held by U. S. Government agencies and trust funds. Includes guaranteed securities.

[2] Includes a small amount of postal savings and prewar bonds not shown separately.

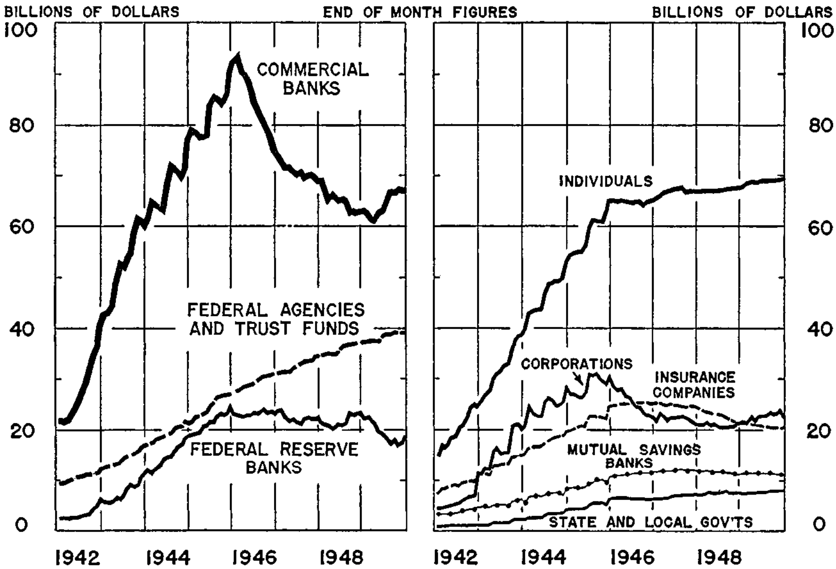
At the end of the year, approximately 69 per cent of the United States Government debt held by the public was in marketable issues, compared with 71 per cent at the end of 1948. During the past three years, while the total marketable debt declined by 21 billion dollars, the amounts due or callable in less than five years showed little change. The proportion of the marketable debt due or callable in less than five years increased from 55 per cent at the end of 1946 to 61 at the end of 1949.

The increase during 1949 in nonmarketable forms of debt held by the public was primarily in savings notes, although there was also some increase in the outstanding amount of savings bonds. Sales of savings notes reached a total of 6.0 billion dollars for the year, with redemptions amounting to 2.9 billion. Approximately half of the redemption was for payment of taxes and the other half was for cash. Sales of Series E bonds exceeded redemptions by 900 million dollars, excluding interest, and sales of F and G bonds exceeded redemptions by 800 million dollars. Taking also into account redemption of about 600 million dollars of maturing Series D bonds, net cash borrowing by the Treasury through its savings bonds sales amounted to about 1.1 billion dollars during 1949.

Ownership of United States Government securities. The cash deficit of the Government in 1949 was financed fully by net sales of securities to nonbank investors. Holdings of Government securities by commercial banks and Federal Reserve Banks, taken as a group, showed little net change over the year. Commercial banks increased their portfolios of Government securities 4.4 billion dollars, utilizing a large part of the reserve funds freed by reductions in reserve requirements or obtained from gold inflows and the return of currency from circulation. The Reserve Banks, as shown by the following chart and table, reduced their holdings by a like amount.

Commercial bank portfolios of bills, certificates, and notes increased 5.7 billion dollars, while their holdings of Treasury bonds declined about 1.4 billion. The net increase in holdings occurred during the last half of the year, when reserve requirements were reduced and money rates declined. The reduction in bond holdings reflected the fact that the bonds purchased by commercial banks, which were supplied by Federal Reserve Banks, mutual savings banks, and insurance companies, amounted to less than bond holdings called for redemption. The called bonds were exchanged principally for notes maturing in four and one-half years and in lesser amounts for short-term types of securities. Commercial banks also increased their holdings of short-term types of securities through substantial net market purchases during the year. At the end of the year about 81 per cent of commercial bank portfolios of Government securities was due or callable within five years, compared with 67 per cent at the end of 1946.

OWNERSHIP OF U. S. GOVERNMENT SECURITIES



NOTE.—Chart relates to gross debt, direct and guaranteed. Reported holdings are shown for Federal agencies and trust funds and for Federal Reserve Banks, and Treasury estimates for other groups.

Reduction in the Reserve System's portfolio of Government securities in 1949 amounted to 4.4 billion dollars. Almost half of this reduction was accounted for by sales of long-term restricted bonds to nonbank investors and mutual savings banks. These groups in turn sold over 2 billion dollars of shorter term bonds to the commercial banks. The Reserve Banks also sold about 1 billion dollars of bank-eligible bonds and a small amount of short-term issues. About 1.2 billion dollars of maturing Government securities held by the System were retired for cash.

The nonbank public increased its total holdings of Government securities by 2.3 billion dollars, approximately the same amount as the total increase in the Federal debt held outside Federal agencies and trust funds. About 1 billion dollars of the increase in nonbank portfolios was due to accrual of interest on savings bonds. Purchases of both savings bonds and savings notes, however, were larger than redemptions, and holdings of marketable restricted issues also increased. Nonbank holdings of bank-eligible marketable securities declined, reflecting primarily cash redemptions of maturing issues. Insurance companies continued to reduce their portfolios of Government securities, and holdings of mutual savings banks changed little over the year. Other corporations, associations, and individuals, however, considerably increased their aggregate invest-

OWNERSHIP OF UNITED STATES GOVERNMENT SECURITIES

[Partly estimated. Par values, in billions of dollars]

Type of investor	Amount held on Dec. 31, 1949	Change in		
		1949	1948	1947
Total of securities outstanding [1]	**257.2**	**+4.3**	**−4.1**	**−2.5**
Held by U. S. Government agencies and trust funds, total [2]	**39.3**	**+2.0**	**+3.0**	**+3.4**
Marketable issues	5.3	−0.2	+0.2	−1.0
Special issues	33.9	+2.2	+2.8	+4.4
Held by the public, total	**217.8**	**+2.3**	**−7.1**	**−5.9**
Federal Reserve Banks, total	*18.9*	*−4.4*	*+0.8*	*−0.8*
Bills, certificates, and notes	11.7	−0.7	−7.4	−2.9
Bank-eligible bonds	2.3	−1.6	+1.7	+1.5
Restricted bonds	4.9	−2.1	+6.4	+0.6
Commercial banks, total	*66.8*	*+4.4*	*−6.3*	*−5.8*
Bills, certificates, and notes	22.5	+5.7	+0.7	−4.8
Bonds, due or callable:				
Within 5 years	30.5	−2.4	−6.1	+10.5
After 5 years	11.6	+1.0	−1.3	−11.3
Nonmarketable issues	2.2	+0.1	+0.4	−0.2
Mutual savings banks	11.4	(3)	−0.5	+0.2
Insurance companies	20.5	−1.0	−2.8	−1.0
State and local governments	8.1	+0.2	+0.6	+1.0
Other corporations and associations [4]	22.6	+1.2	+0.2	−1.2
Individuals [5]	69.5	+1.9	+1.0	+1.7

[1] Includes guaranteed securities.

[2] Includes the Postal Savings System and also includes nonmarketable issues not shown separately.

[3] Less than 50 million dollars.

[4] Includes savings and loan associations, dealers and brokers, and investments of foreign balances and international accounts in this country.

[5] Includes partnerships and personal trust accounts.

ment in Government securities, and holdings of State and local governments showed a small further rise.

ECONOMIC DEVELOPMENTS IN 1949

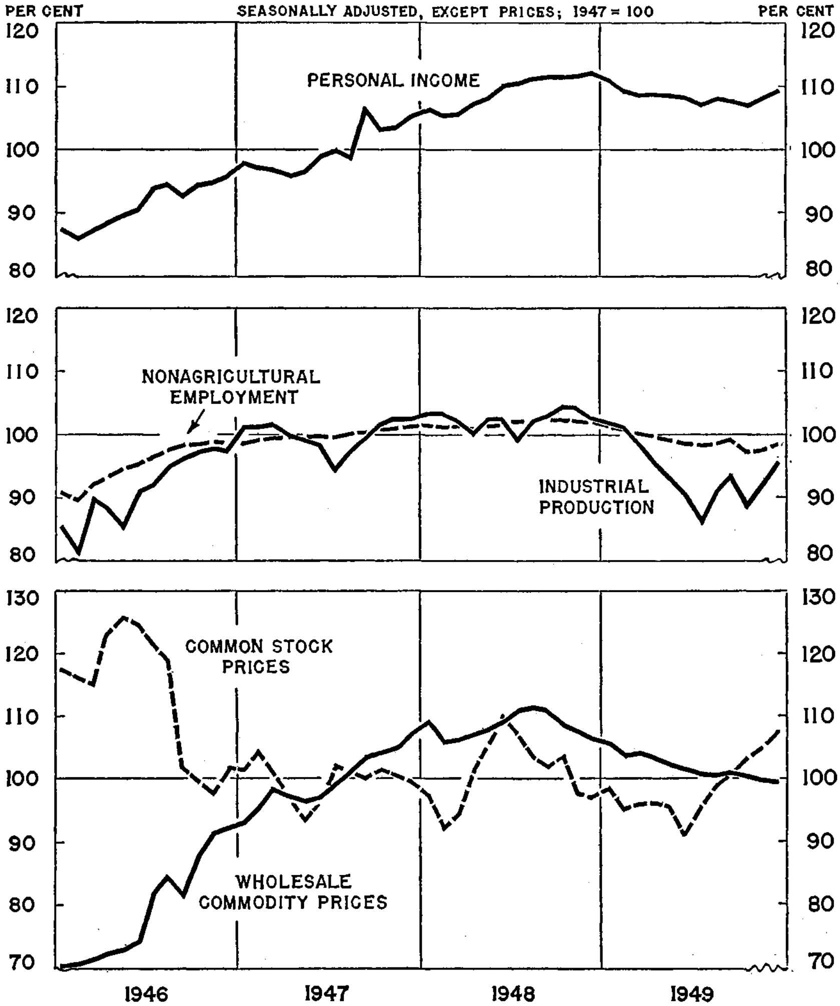
Production, employment, and incomes in the United States declined in the first half of 1949, increased moderately in the second half, and for the year as a whole were at levels which, though below those of 1948, were high relative to most other periods. Production in manufacturing and mining, down 8 per cent from the 1948 level, was nevertheless 76 per cent above the 1935-39 average—as compared with a 16 per cent increase in population—and 40 per cent above the 1940 level. Production other than manufacturing and mining and related transportation activities was reduced much less; aggregate output of goods and services was down only moderately from the 1948 level. With some reduction in employment—reflecting increased productivity as well as reduced output—and a further growth in the labor force, unemployment in 1949 was above the low levels prevailing earlier in the postwar period.

The shift in demand-supply conditions reflected in the decline in output and employment was also evident in a decline in commodity prices, but here again the decline was limited largely to the first half of the year and was moderate. Wholesale prices at the end of the year, while 11 per cent below the August 1948 peak and 8 per cent below the 1948 average, were still nearly double the prewar level. The cost of living showed very little decline during 1949 and was still two-thirds above prewar. With a generally easier labor market and the cost of living tending to decline rather than advance, wage rates showed much less rise during 1949 than in earlier postwar years and changes to a greater extent took the form of increased pensions and other such benefits.

Reflecting chiefly inventory losses as contrasted with inventory gains in 1948, corporate profits in 1949 were about one-sixth below the peak year 1948. Common stock prices advanced steadily in the second half of 1949 to levels equal to the highest reached during 1948, reflecting such factors as more favorable profit reports than had been anticipated and a reappraisal of the whole situation accompanying the favorable turn of affairs in midyear. Farm land values, although under some downward pressure as a result of a 15 per cent reduction in net farm income from 1948 to 1949, at the year-end were still double the prewar average. Urban property values were at levels close to postwar peaks.

Recession in first half. Within the year 1949, economic conditions showed very marked changes, some of which are indicated on the accompanying chart. At the beginning of the year the in-

SELECTED BUSINESS INDEXES



NOTE.—Income, Department of Commerce; employment, Bureau of Labor Statistics and Federal Reserve; stock prices, Standard and Poor's Corporation (416 shares); wholesale prices, Bureau of Labor Statistics. These series and industrial production index converted to 1947 base by Federal Reserve.

fluence of long-sustained high rates of production, large supplies of goods on hand, and declining prices for numerous commodities came to be felt over a widening area of the economy. Prices of agricultural products continued the decline of the latter part of 1948. Weakness in markets for textiles, paper, and some other nondurable goods was reflected in some part in price reductions but to a large extent in reductions in output, beginning in the latter part of 1948 and continuing until mid-1949.

In metal markets the strong situation of late 1948 was reversed and beginning in January prices of metal scrap generally and of new nonferrous metals declined sharply. This weakening followed a marked reduction in consumer takings of household equipment beginning in the autumn of 1948 and, much more important, reductions in business orders for machinery and a wide variety of other finished metal products. Steel consuming industries accumulated steel stocks during the winter and spring, and after March the changed demand situation was reflected in a declining rate of steel production. Also, a greater than seasonal decline in residential building in the latter part of 1948 and in early 1949 contributed to a curtailment of demands for building supplies and to the weakening in the general situation at that time.

On the other hand, an expanded volume of exports under the Economic Cooperation Administration program tended to strengthen the situation early in the year and the operation of the farm price support program—extended somewhat at the time—limited price declines for many agricultural products. Continuing strong demand for automobiles was a sustaining factor in this period.

In the second quarter, while prices of materials and industrial production continued to decline, residential building increased much more than seasonally. This increase, leading eventually to a total of over 1 million new housing units in 1949 as compared to 930,000 in 1948, followed some downward adjustment in prices of new houses and some easing of credit terms. Activity in this field proved to be one of the major factors leading to a reversal of the downward movement in the economy in midyear and an advance thereafter. Another important factor was sustained spending for consumer goods and services. Consumer expenditures as a whole showed no decline after the first quarter and, with some decline in retail prices, unit purchases showed some increase. Automobile purchases reached new high levels as more new cars became available and as instalment credit terms were relaxed. Purchases of household equipment revived somewhat toward the end of the second quarter. Government outlays for goods and services increased further in this period, with outlays for some purposes expanding substantially. Unemployment payments also increased, offsetting to some degree the net loss of wage income in manufacturing and mining and on the railroads. Exports continued at a high level during the second quarter despite a marked decline in imports and deterioration in the monetary reserve positions of some foreign countries.

Moderate recovery in second half. With production of both nondurable goods and durable goods curtailed more than consumption, inventories were reduced somewhat during the second quarter and the way was paved for a revival of production. New orders for producers' equipment, moreover, had been for a considerable period at levels much below current production and unfilled orders had been drawn down from earlier high levels. Under these circumstances, in midsummer, with demands in the residential building, public construction, and automobile fields very strong, business buying revived and the downward movement in prices and production was stopped before the recession had extended far into the economy. Thus, while industrial production in June and July averaged 15 per cent below the peak reached in the autumn of 1948, aggregate output of goods and services in the economy was down only about 6 per cent in dollar terms and less than that in physical volume. The decline in personal income from the peak was very moderate—only about 4 per cent.

With the revival of business buying in midsummer, prices of industrial materials recovered somewhat and production at factories and mines rose. The increases in output were marked in nondurable lines where inventories had been depleted. Thus, revival in the textile and paper industries came very fast. Owing to the continuing threat of a steel strike, steel consumers continued to hold large stocks of steel and, with consumption remaining at a high level, output at steel mills during the third quarter was generally above 80 per cent of capacity. Automobile demand for steel reached new high levels. Meanwhile, reflecting the strengthening in the whole situation, buying of some producers goods rose from earlier low levels and production of machinery, which had declined at a rapid rate in the first half of the year, showed little further change, at a level one-fifth lower than in 1948. Industrial production as a whole was up 9 points in September from the June-July average, at 174 instead of 165.

In October and the early part of November output in the steel industry was reduced by a prolonged strike but the effects of the strike in reducing output in other industries were very limited. Then steel output increased again to more than 90 per cent of capacity, reflecting demands for steel to replenish inventories as well as to meet current requirements. Building material output was high throughout the fourth quarter. So also was output of nondurable goods. Fuel production, on the other hand, was interrupted by strikes, and demand for fuels was limited by mild weather and a level of activity in industry and on the railroads still below the highs of 1948. Total industrial production in December was at 180 per cent of the 1935-39 average, halfway between the June-July low and the 1948 autumn high.

During the second half year there was some further decline in prices of farm products and foods and, although prices of industrial materials rose somewhat, other prices as a group showed little change. Crops were again large in 1949 and supplies of livestock products became more plentiful, reflecting the influence of the heavy grain crops of 1948. Nonferrous metal prices, which had declined by 40 per cent in the first half-year, advanced moderately in the third quarter as buying increased. Finished steel prices, which had been mostly maintained, except for premium charges of various sorts, were advanced 4 per cent in December. Consumer prices for goods and services generally were stable in the second half of the year except mainly for declines in food prices at the year-end and a continued gradual advance in rents and utility charges.

Thus prices both at wholesale and retail were unusually stable in the second half of 1949. The devaluations of foreign currencies beginning in mid-September apparently had little effect on the price level in this country, partly because of the strengthening of domestic markets which had begun in midyear. The longer term effects of the devaluations on markets abroad and in this country could not be immediately determined.

Wage rates in manufacturing continued to show little change during the second half of the year except in terms of pension benefits agreed to in the steel industry after the strike and in some other cases after negotiations. Railroad wage rates rose as scheduled hours for nonoperative personnel were reduced in September, in accordance with a contract made earlier, and there were also some advances in the pay of Government employees.

INTERNATIONAL TRADE AND FINANCE

Unprecedentedly rapid and widespread readjustments of foreign currency values were the outstanding development of 1949 in international trade and finance. These began on September 18 with the devaluation of the pound sterling by 30.5 per cent or from $4.03 to $2.80. Changes followed in the currencies of 29 countries, including most countries in the sterling area and Western Europe, as well as Canada, Egypt, and others. The sterling area, Scandinavia, and several other countries with close economic ties to the United Kingdom devalued by the full 30.5 per cent necessary to keep their currencies at par with sterling. Other countries devalued less. A number of countries, chiefly in Latin America, altered their multiple rate structures so as to reduce the effective rates of exchange applicable to various types of transactions. The International Monetary Fund concurred in the changes made by its member countries.

The currency changes were precipitated by a sharp deterioration in the British gold and dollar position in the second and third quarters of 1949. More basic causes, however, are to be found in the postwar distortions affecting price-cost relations and trade patterns, which persisted in Europe and other parts of the world despite the encouraging progress in recovery and reconstruction which had been achieved by the end of 1948. There was growing recognition that these distortions would probably prevent the achievement of balance-of-payments equilibrium by the end of the European Recovery Program, if more drastic measures were not taken. At the same time, the recovery of European production and the general tapering off of internal monetary expansion favored the success of currency devaluation in 1949 as a step toward longer term economic equilibrium.

The immediate effects of the currency changes on trade and gold and dollar positions were favorable, partly because the speculative positions taken earlier against the devalued currencies were reversed. Total foreign holdings of gold and short-term dollar balances, which had declined from 14.9 billion dollars at the beginning of the year to 14.6 billion on September 30, rose to 15.2 billion by the end of December. British gold and dollar reserves recovered by about 350 million dollars from September 18 to the end of the year. Tightening of import and exchange controls by some countries contributed to the over-all gain in foreign gold and dollar reserves.

Changes in dollar prices consequent to the currency devaluations were varied. On the whole, dollar prices of exports from devaluing countries declined. This improved their general competitive position in world markets. At the same time, the dollar prices of raw materials imported by the United States from devaluing countries declined much less than the average price level of their exports, and by the year-end, dollar prices of most leading imported raw materials had risen to pre-devaluation levels. This development, resulting in part from the expanding business activity in the United States, had additional favorable effects on the dollar position of the devaluing countries.

United States balance of payments. Changes in the United States balance of payments during 1949 reflected in part the factors already referred to in connection with currency devaluations. The current account surplus in the United States balance of payments, which had been reduced from the postwar peak level of 11.5 billion dollars in 1947 to 6.7 billion in 1948, increased to an annual rate of 8.0 billion in the second quarter of 1949. Contributing to this increase were both an increase in United States exports and a decline in imports. There was a sharp decline in the current account surplus during the remainder of the year.

The decline in economic activity and the accompanying inventory adjustments in the United States during the first half of the year contributed to the reduction of the value of imports, although part of the reduction (and also of the increase in exports) was due to anticipation of currency devaluations. In some countries, particularly in the sterling area, this decline in United States imports had serious repercussions. In other countries, particularly on the

European continent, it was more than compensated by the decline in prices of United States exports.

Because of the increase in the United States surplus on current account, gold sales to the United States increased in the second quarter of 1949, and foreign dollar bank balances, which had been increasing during 1948 and in the first quarter of 1949, were again drawn down to meet foreign needs. As will be seen by reference to the table on the following page, this occurred despite the large amount of United States foreign aid extended in the second quarter.

In the third quarter, the current account surplus dropped sharply from 2 billion dollars to 1.3 billion, almost entirely because of a decline in exports. Part of this decline was due to increased restrictions by sterling area governments on dollar imports as a means of combating unfavorable dollar positions.

Following foreign currency devaluations, the current account surplus declined in the fourth quarter to its lowest postwar level, 1.1 billion dollars. The rise in recorded United States imports from 1.5 billion dollars in the third quarter to 1.8 billion in the fourth quarter was in part a seasonal development, in part a result of the upturn in United States business activity, and in part a reflection of increases in the price of coffee. The price effects of the devaluations also began to be felt, especially where imports had previously been deferred in anticipation of the devaluations. The low recorded export figure of 2.6 billion dollars for the fourth quarter was partly attributable to restrictive measures taken by foreign countries on their imports and to increased production abroad.

Partly as a consequence of the movements in trade, gold movements were abruptly reversed in the fourth quarter, with a net outflow from this country of 150 million dollars. The outflow was also attributable in part to the reversal of speculative positions against foreign currencies and to gold purchases by foreign monetary authorities wishing to inspire confidence in newly established currency values.

For 1949 as a whole, the reduction from 1948 in the United States current account surplus was the consequence of the decrease in export proceeds. This decrease resulted from reductions in prices and, in the latter part of the year, a decline in export volume. The latter decline would have had more serious effects in the United

States had not the devaluation of foreign currencies coincided with an upturn in business activity here. With United States Government foreign loans and grants at higher levels than at any time except during the war years, and with foreign gold and dollar reserves near their postwar low, the decline in United States exports

FOREIGN TRADE OF THE UNITED STATES AND MEANS OF FINANCING[1]

[In billions of dollars]

Item	1949					1948
	First quarter	Second quarter	Third quarter	Fourth quarter	Year	
U. S. exports, total	**4.3**	**4.4**	**3.7**	**3.6**	**16.0**	**17.1**
Recorded exports	3.3	3.4	2.7	2.6	12.0	12.7
Other goods and services	1.0	1.0	1.0	1.0	4.0	4.1
U. S. imports, total	**2.6**	**2.4**	**2.3**	**2.4**	**9.7**	**10.4**
Recorded imports	1.8	1.6	1.5	1.8	6.6	7.1
Other goods and services	0.8	0.8	0.8	0.6	3.1	3.4
Net purchases from U. S. by foreign countries	**1.8**	**2.0**	**1.3**	**1.1**	**6.2**	**6.7**
Sources of financing utilized by foreign countries:						
U. S. Government, net total	**1.7**	**1.7**	**1.5**	**1.1**	**5.9**	**5.1**
Credits	0.3	0.1	0.2	0.1	0.6	0.9
Donations	1.4	1.5	1.3	1.1	5.3	4.2
U. S. private, net total	**0.3**	**0.2**	**0.3**	**0.3**	**1.1**	**1.5**
Foreign investment, long- and short-term	0.2	0.1	0.2	0.2	0.6	0.9
Donations	0.1	0.1	0.1	0.1	0.5	0.7
International Bank and Monetary Fund	(2)	(2)	(2)	**0.1**	**0.1**	**0.4**
Foreign countries' capital assets, net total	(2)	**0.4**	**0.1**	[3]**−0.4**	(2)	**0.8**
Sales of gold to U. S.	0.1	0.2	0.1	−0.2	0.2	1.5
Liquidation of long- and short-term dollar assets	[3]−0.1	0.2	(2)	[3]−0.3	[3]−0.2	[3]−0.7
Errors and omissions	**−0.3**	**−0.3**	**−0.5**	**+0.1**	**−1.0**	**−1.0**

[1] This table is derived largely from U. S. balance-of-payments data compiled by the U. S. Department of Commerce, as revised and published in *Survey of Current Business*, June 1950, pp. 11–18.

[2] Less than 50 million dollars.

[3] Increase.

could have been avoided only by an increase in United States imports or a larger volume of private investment abroad.

In an effort to encourage the expansion of foreign private investment, several bills have been introduced in Congress in connection with the President's Point Four program for technical assistance to underdeveloped countries. Consideration has been given to a bill that would empower the Export-Import Bank to extend guarantees to United States investors against certain risks peculiar to foreign investment. The President has also recommended that Congress enact more favorable tax provisions for income from foreign sources, and the State Department is engaged in negotiating treaties providing equitable treatment for United States investments in foreign countries.

Progress in European recovery. Production continued to increase in European countries receiving American aid in 1949. Prewar levels of production were exceeded by about 15 per cent in industry and were almost reached in agriculture. Toward the end of the year, however, a slackening of the increase in industrial production became noticeable in most European countries.

Inflationary pressures abated in many countries during 1949. France, for instance, where prices had risen by 62 per cent in the course of 1948, consolidated the stabilization that had been achieved toward the end of 1948. In the United Kingdom, on the other hand, inflationary pressures were still felt as a result of higher Government expenditures, of inventory accumulation prior to devaluation, and of increases in sterling prices of many imports following devaluation. At the same time, unemployment remained or became a problem in countries like Germany, Italy, and Belgium.

With the decisive breaking of production bottlenecks and the stoppage of the most dangerous inflationary conditions in European countries, the first aim of the European Recovery Program has been achieved. There remains the problem of reducing the large dollar gap in the balances of payments of these countries, which is being approached along three main lines.

The first is a direct and immediate expansion of European dollar earnings. The currency adjustments already made will help to bring this about. Also, the United States Government is continuing to negotiate for reciprocal tariff concessions under the Trade Agreements Act and to work toward simplifying our customs procedures.

Secondly, the Economic Cooperation Administration proposes to modify its method of allocating funds among European countries so as to give them increased incentives to improve their dollar balances of payments. Future aid to individual countries would not be based on new calculations of "requirements," but would generally reflect uniform percentage cuts from 1949-50. This would assure European countries that any improvement in their balances of payments beyond the target would result in increases of their monetary reserves rather than in less aid during a subsequent period.

Finally, an effort is being made to remove obstacles to the functioning of the European economy as an efficient unit. To promote productivity, intra-European competition, and the efficient allocation of European resources, an attempt has been initiated to remove quantitative restrictions of imports—the most disruptive impediment to a free intra-European flow of goods and services. Among further steps, it is contemplated that the European countries will set up a payments system which will make the European currencies transferable among the countries participating in the Recovery Program.

CHANGES IN BANKING STRUCTURE

Number of banking offices. The number of banking offices in the United States increased by 207 in 1949, as a result of a decrease of 16 in the number of banks and an increase of 223 in the number of branches and additional offices. The net increase of 207 in the number of banking offices was the sixth consecutive annual increase. It was slightly more than the increase of 189 in 1948 and identical with the increase in 1947. At the end of 1949 there were 19,371 banking offices (14,687 banks and 4,684 branches and additional offices). All of these figures exclude banking facilities at military and other Government establishments, of which there were 94 at the end of 1949, an increase of 24 for the year. There were about 350 of these banking facilities at the end of the war.

For the second successive year the number of banks (head offices) declined. The net decrease was 16, as compared with 11 in 1948 and with increases in the three preceding years. The number of new banks opened for business declined for the third consecutive year; of the 73 opened, 18 were member banks, 43 were insured nonmember banks, and 12 were noninsured banks. A total of 95 banks went out of existence through consolidations, liquidations, and suspensions, but 59 of them became branches. Four small noninsured banks (three of which were unincorporated private banks) suspended operations; their aggregate deposits were about 2.5 million dollars. Of the 14,687 banks in operation on December 31, 14,156 were commercial banks and 531 were mutual savings banks.

The number of branches and additional offices, exclusive of banking facilities at military and other Government establishments, increased by a net of 223 during the year. This was the largest increase since 1934, and compares with 200 in 1948. The number of such offices has increased in every year since 1933 except in 1942, when it remained unchanged.

About a third of the new banks opened for business in 1949 were in Illinois and Texas, where branch banking is prohibited, and in Georgia, where branches may be established only in the large cities. About a third of the new branches established were in California, Massachusetts, Michigan, and New York, where either State-wide or city branch banking has had considerable development.

Changes in Federal Reserve membership. As a result principally of consolidations and conversions of banks into branches, the number of member banks decreased by 26 during 1949, compared with a net decrease of 5 in 1948 and with net increases totaling 585 in the preceding nine years. National banks decreased by 16 and State member banks by 10. Consolidations, absorptions, withdrawals from membership, etc., more than offset accessions to membership. Of the 36 banks added to membership, 15 were national banks and 21 were State banks; and of the latter, 6 were newly organized and 15 were already in operation. These 15 had total deposits of 161 million dollars, and all but 3 were already insured.

The 6,892 member banks in operation at the end of 1949 accounted for 49 per cent of the number and 85 per cent of the deposits of all commercial banks in the country. State member banks accounted for 21 per cent of the number and 65 per cent of the deposits of all State commercial banks. These percentages have varied only fractionally during the past few years.

Although nearly one-half of all commercial banks in the country are members of the Federal Reserve System, the proportion that are members in the various States ranges from 87 per cent in New York to 24 per cent in Iowa. The States with the largest number and proportion of member banks are, with some exceptions, in the northern and eastern sections of the country, while the nonmember banks are concentrated more in the midwestern and southern sections of the country. The differences in proportion of member and nonmember banks in the various States may be attributed to a number of factors, including the extent to which banking facilities are provided by means of branch systems rather than by single-unit banks, the number of nonpar banks, and differences between State capital requirements and those prescribed by Federal law for admission to Federal Reserve membership.

Nonmember banks eligible for membership. As mentioned briefly in last year's report, preliminary analysis of a survey made by the Reserve Banks as of December 31, 1948 indicated that nearly one-third of the nonmember commercial banks were ineligible for membership in the Federal Reserve System on the basis of minimum statutory capital requirements. Further study of the survey data indicates that 5,081 nonmember commercial banks, or slightly over 70 per cent of the total, were eligible for membership and 1,890 were ineligible.[1]

Of the 1,890 ineligible banks, 475 were ineligible because they were operating one or more branches that were established outside their respective head-office cities after February 25, 1927, the date of the enactment of the McFadden Act. Of these 475 banks, 218 were in the Chicago Federal Reserve District, with Iowa and Wisconsin accounting for 163. These banks would be eligible for membership if it were not for the statutory capital stock requirements applicable to banks operating such branches. In addition, it is estimated that at least 200 banks would become eligible for Federal Reserve membership if they converted a relatively small portion of surplus and undivided profits into capital stock. With their pres-

[1] The following classes of banks were excluded from this study: 131 private banks, 67 trust companies without deposits, 37 noncheck industrial banks, 24 cash depositories in South Carolina, 9 guaranty savings banks in New Hampshire, 7 cooperative exchanges in Arkansas, and 10 miscellaneous financial institutions, a total of 285 banks.

ent capital structure, they are ineligible for membership, because the law prescribes capital requirements in terms of capital stock.

Par and nonpar banks. During 1949 there was a net increase of 117 in the number of banks on the Federal Reserve Par List and a net decrease of 138 in the number of nonpar banks.[2] These changes were considerably larger than in other recent years and reflected principally changes in Wisconsin. The Wisconsin par clearance bill became effective in June 1949; it provided for the clearing at par of checks drawn on all banks organized under the law of that State and, as a result, 107 nonpar banks were added to the par list.

During the year, a total of 196 banks were added to the par list, 3 were withdrawn, and 76 banks formerly on the list terminated existence. Of these 76 banks, 71 were absorbed by other par banks (including 53 that were converted into branches), 1 suspended, and 4 were liquidated.

At the end of 1949 there were 12,178 par-remitting and 1,873 nonpar banks. The latter represented only 13 per cent of the banks on which checks are drawn and held only a very small proportion of the deposits with all commercial banks in the country. There were 4,289 par-remitting branches and 273 nonpar branches of commercial banks.

At the end of the year there were 6 Federal Reserve districts and 29 States and the District of Columbia in which all banks were on the Federal Reserve Par List. In each of 5 other States the number of nonpar banks was less than 10. Over 99 per cent of the banks not on the par list were in the following 14 States: Minnesota 414; Georgia 291; Mississippi 162; Arkansas 123; North Carolina 114; Louisiana 103; South Dakota 99; Alabama 96; Tennessee 93; South Carolina 88; North Dakota 87; Missouri 66; Florida 62; and Texas 57.

Check routing symbols. The program inaugurated by the American Bankers Association and the Federal Reserve System in June 1945 to facilitate check collection by use of routing symbols made additional progress during 1949. A survey conducted as of December 1, 1949 showed that practically all banks handling a sizable volume of checks made extensive use of the routing symbols. It

[2] The Federal Reserve Par List comprises all member banks, which are required under the law to remit at par for checks forwarded to them by the Federal Reserve Banks for payment, and also such nonmember banks as have agreed to do so.

was also found that 67 per cent of all checks cleared through Federal Reserve Banks carried routing symbols in the approved location; this percentage compares with 58 on December 1, 1948.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

On July 15, 1949, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Executive Committee of the National Association of Supervisors of State Banks, and the Board of Governors issued a joint statement announcing the adoption of certain changes in the bank examination and reporting procedure which had been followed by the supervisory agencies since July 1938. The revision provided for abandonment of Roman numerals II, III, and IV in the examiners' classification of bank assets, and the substitution of the terms "substandard," "doubtful," and "loss." It provided also for the discontinuance of the practice of appraising Group 2 securities on the basis of the 18-month average of market value and, instead, their appraisal at current market value. The purpose of the revision was the clarification and simplification of procedure in the interest of more uniform application. It did not involve a fundamental change in procedure nor signify any intention on the part of the supervisory authorities to become more severe in the classification of assets.

In accordance with the practice of previous years, a conference of the Vice Presidents in charge of bank examination and supervision at the several Federal Reserve Banks, and the chief examiners at such banks, was held in Washington in early 1949. The representatives of the Reserve Banks met with members of the Board of Governors and members of the Board's staff to consider current supervisory problems. Representatives of the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency also attended the conference. At the annual convention of the National Association of Supervisors of State Banks, held in Reno, Nevada, in October, effective discussions were held between representatives of the Board and officers of the bank examination departments of each of the Reserve Banks, who were in attendance at the convention.

During the year the Board continued to maintain formal and informal contacts on matters of mutual interest pertaining to bank examination and supervision with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Executive Committee of the National Association of Supervisors of State Banks.

Examination of Federal Reserve Banks. The Board's Division of Examinations examined each of the twelve Federal Reserve Banks and their twenty-four branches during the year as required by law.

Examination of State member banks. State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. In order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking authorities or alternate examinations are made by agreement with State authorities. The 1949 program for the examination of State member banks was practically completed.

Bank holding companies. During 1949 the Board authorized the issuance of two voting permits for limited purposes to holding company affiliates of member banks.

The regular annual reports were obtained from holding company affiliates to provide information with respect to the organizations to which voting permits have been granted. In accordance with established practice, a number of holding company affiliates were examined during the year by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

Section 301 of the Banking Act of 1935 provides that the term "holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to three organizations.

Trust powers of national banks. During the year 1949, 13 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11(k) of the Federal Reserve Act. This number includes the grant of additional powers to 3 banks which previously had been granted certain trust powers. Trust powers of 22 national banks were terminated, 17 by voluntary liquidation or consolidation and 5 by voluntary surrender. At the end of 1949, there were 1,776 national banks holding permits to exercise trust powers. A list of such banks, with indication of the power or powers each bank is authorized to exercise, will be supplied to those requesting it.

Foreign branches and banking corporations. During 1949 the Board approved two applications made by member banks pursuant to the provisions of Section 25 of the Federal Reserve Act for permission to establish foreign branches. Member banks opened three foreign branches in 1949, one each in China, Japan, and Thailand. Two of the three branches so established had been authorized in previous years. The types of banking operations conducted by branches in Germany and Japan continue to be restricted by the terms of the licenses issued by the occupation authorities.

At the end of 1949, seven member banks had in active operation a total of 92 branches in 23 foreign countries and possessions of the United States. Of the 92 branches, four national banks were operating 86, and three State member banks were operating 6. The foreign branches in active operation were distributed geographically as follows:

Latin America	**46**
Argentina	10
Brazil	8
Chile	2
Colombia	3
Cuba	16
Mexico	1
Panama	3
Peru	1
Uruguay	1
Venezuela	1
Continental Europe	**5**
Belgium	1
France	1
Germany	3
England	**10**
Far East	**20**
China	2
Hong Kong	1
India	2
Japan	8
Philippines	5
Singapore	1
Thailand	1
U. S. Possessions	**11**
Canal Zone	4
Puerto Rico	7
Total	**92**

There was no change during the year in the corporations organized under State laws which operate under agreements entered into with the Board pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged principally in international or foreign banking. These four corporations are First of Boston International Corporation, International Banking Corporation, Morgan & Cie. Incorporated, and Bankers Company of New York. One of the four has no affiliates or branches, one operates a branch in England and one in France, one operates a branch in France, and one has an English fiduciary affiliate.

During the year the Board's Division of Examinations examined the head office of The Chase Bank, organized under the provisions of Section 25(a) of the Federal Reserve Act and chartered by the Board to engage in international or foreign banking. Currently the bank has a fiduciary affiliate in England, and operates one branch each in France, China, and Hong Kong. One branch formerly operated in China was closed during the year under the provisions of the Board's Regulation M, due to disturbed conditions. The Board approved in 1949 an extension for a period of 20 years of the bank's corporate existence, which would have expired in 1950.

Bank of America, New York, New York, an affiliate of Bank of America National Trust and Savings Association, San Francisco, California, was organized in late 1949 under the provisions of Section 25(a) of the Federal Reserve Act and chartered by the Board to engage in international or foreign banking.

CHANGES IN REGULATIONS OF THE BOARD OF GOVERNORS

Discounts for and advances to member banks. The Board's Regulation A, relating to discounts for and advances to member banks by Federal Reserve Banks, was amended effective February 17, 1949, to permit the discount of notes evidencing loans which are made pursuant to a commodity loan program of the Commodity Credit Corporation and are subject to a commitment to purchase by that Corporation. Provision also was made for the use of certificates of interest such as are issued by the Commodity Credit Corporation under its cotton loan program as security for advances to member banks. An obsolete provision concerning loans subject to guarantees or commitments pursuant to Executive Order No. 9112 or the Contract Settlement Act of 1944 was eliminated.

Reserves of member banks. The Board's Regulation D, relating to reserves required to be maintained by member banks with Federal Reserve Banks, was amended effective May 5, 1949, as to banks in reserve and central reserve cities, and effective May 1, 1949, as to other member banks, to reduce the required reserves against time deposits from 7.5 to 7 per cent for all member banks, and to reduce the required reserves against demand deposits from 26 to 24 per cent for central reserve city banks, from 22 to 21 per cent for reserve city banks, and from 16 to 15 per cent for other member banks.

In connection with the expiration on June 30, 1949, of the temporary authority of the Board to require increased reserves for member banks, Regulation D was amended effective June 30, 1949, as to banks in reserve and central reserve cities, and effective July 1, 1949, as to other member banks, to require reserves against time deposits of 6 per cent for all member banks, and reserves against demand deposits of 24 per cent for central reserve city banks, 20 per cent for reserve city banks, and 14 per cent for other member banks.

In August 1949, Regulation D was amended to reduce the required reserves of all member banks by 2 percentage points on demand deposits and 1 percentage point on time deposits. The reduction as to demand deposits became effective in one-half per cent amounts on August 11, 18, and 25, and September 1, 1949, for reserve and central reserve city banks, and in 1 per cent amounts on August 1 and 16, 1949, for other member banks. The reduction as to time deposits became effective August 11, 1949, for reserve and central reserve city banks, and on August 16, 1949, for other member banks.

Trust powers of national banks. The Board's Regulation F, relating to trust powers of national banks, was amended effective May 20, 1949, to provide that any security which is a direct obligation of the United States may be regarded as a readily marketable security within the meaning of Section 17, which relates to common trust funds.

Check clearing and collection. As stated in the Board's Annual Report for 1948, the Board's Regulation J, relating to the clearing and collection of checks by Federal Reserve Banks, was amended effective January 1, 1949, to permit conditional payment of checks and other cash items and the return of unpaid items on the following day.

Margin requirements for purchasing securities. The Board's Regulation T, relating to the extension and maintenance of credit by brokers, dealers, and members of national securities exchanges, and Regulation U, relating to loans by banks for the purpose of purchasing or carrying stocks registered on a national securities exchange, were amended effective March 30, 1949, to reduce the margin requirements from 75 per cent to 50 per cent.

Effective May 1, 1949, Regulations T and U were amended to relax the provisions relating to substitutions of securities in undermargined accounts, and Regulation T was amended to simplify operations in special cash accounts. Effective May 16, 1949, the regulations were amended to permit a 25 per cent margin in the case of securities acquired through subscription rights when specified conditions are met.

Effective July 20, 1949, Regulations T and U were amended to remove margin requirements applicable to credit for financing the functions of specialists on securities exchanges designated by the Board as requiring suitable reports concerning the use of such credit; and the New York Stock Exchange was so designated, effective until further notice. Regulation T also was amended to relax requirements with respect to the period within which payment must be obtained for "when distributed" securities purchased in a special cash account.

Consumer instalment credit. The Board's authority to issue Regulation W, relating to consumer instalment credit, expired on June 30, 1949, and the regulation ceased to be operative after that date. As stated elsewhere in this report, the regulation had been amended effective March 7 and again effective April 27 to relax its requirements in various respects. Through these two actions, the standard maximum maturity for all credits under Regulation W became 24 months instead of 15 to 18 months, and the minimum down payment on listed articles such as furniture and appliances was reduced from 20 to 10 per cent. The one-third down payment on automobiles remained unchanged. Articles costing less than $100 were exempted from the regulation, compared with the previous exemption of articles costing less than $50. Certain technical changes in the regulation were made, effective January 1 and March 7, 1949.

HEARING

Hearing under Clayton Antitrust Act. As noted in the previous Annual Report, the Board, on June 24, 1948, issued its Complaint against Transamerica Corporation, San Francisco, California, together with a notice of hearing to determine whether an order should be entered requiring the Corporation to cease and desist from violating Section 7 of the Clayton Antitrust Act.

The actual taking of testimony began in Washington on February 2, 1949, with the presentation of evidence on behalf of the Board. The hearings were conducted before a member of the Board, R. M. Evans, who had been designated by the Board as Hearing Officer. On February 15, 1949, the hearings were adjourned to San Francisco where they were reconvened on March 28, 1949. The Board's Solicitor rested his case on July 8, 1949. After an interval, during which certain motions were argued and a recess was taken, the hearing of evidence on behalf of the Respondent was begun on September 19, 1949. The hearing had not been concluded at the end of 1949.

LEGISLATION

Consumer instalment credit. Under the terms of the Joint Resolution approved August 16, 1948, which authorized the Board to regulate consumer instalment credit during a period ending June 30, 1949, the Board's authority to regulate such credit expired on the latter date.

Reserves of member banks. The additional authority to increase member bank reserve requirements which was granted to the Board by an amendment to Section 19 of the Federal Reserve Act contained in the Joint Resolution approved August 16, 1948, expired on June 30, 1949.

Salaries. An Act approved October 15, 1949, in effect amended Sections 10 and 12B of the Federal Reserve Act by increasing the rate of basic compensation of the members of the Board of Governors of the Federal Reserve System and the Board of Directors of the Federal Deposit Insurance Corporation from $15,000 to $16,000 per annum.

International Bank obligations. An Act approved June 29, 1949, amended Section 5136 of the Revised Statutes of the United States so as to remove restrictions upon national banks and State member banks with respect to dealing in and underwriting obligations issued by the International Bank for Reconstruction and Development, subject to the limitation that a bank's holdings of such obligations shall not exceed 10 per cent of its capital and surplus. The Act also amended the Bretton Woods Agreements Act to exempt from the provisions of the Securities Act of 1933, and the Securities Exchange Act of 1934, securities issued or guaranteed by the International Bank.

Housing obligations. The Housing Act of 1949, approved July 15, 1949, amended Section 5136 of the Revised Statutes of the United States so as to remove restrictions upon national banks and State member banks with respect to dealing in, underwriting, and purchasing for their own accounts certain obligations of local public agencies and public housing agencies secured by agreements with Federal housing authorities. The Act also amended Section 5200 of the Revised Statutes to provide that the limitations upon loans by a national bank to any one borrower shall not apply to similar obligations of such agencies.

Real estate loans. An Act approved October 25, 1949, amended Section 24 of the Federal Reserve Act, relating to real estate loans by national banks, to permit such banks to make loans on certain types of long-term leaseholds under rules and regulations prescribed by the Comptroller of the Currency, and also to permit them to finance the construction of military rental housing under Title VIII of the National Housing Act.

LEGISLATIVE PROPOSALS

Bank holding companies. In previous Annual Reports the Board has recommended legislation to provide more effective supervision and control of bank holding companies, including provisions controlling expansion and requiring the divorcement of activities unrelated to banking. Hearings on this subject were held by the Senate and House Committees on Banking and Currency of the 80th Congress and a bill recommended by the Board was reported favorably by the Senate Committee. Thereafter, the proposed legislation was discussed further with various interested groups and, with a number of changes which did not affect its basic objectives, was introduced in the present Congress.

State member bank capital requirements. Upon the recommendation of the Board, S. 2494 and H. R. 5749 have been introduced for the purpose of modifying the capital requirements for the admission of State banks to membership in the Federal Reserve System and for the establishment of out-of-town branches by State member banks. The present requirements prevent many sound banks with adequate capital from becoming members of the Federal Reserve System. They also tend to force State member banks which would like to remain in the System to withdraw from membership and operate as nonmember banks in order to establish branches. The proposed legislation would vest in the Board discretion to determine the adequacy of the capital of State banks applying for membership and of State member banks desiring to establish branches, except that a minimum capital stock of $50,000 (or $25,000 for banks heretofore organized) would be required for membership.

Federal Reserve branch buildings. In 1947 the Board called attention to the fact that the need for more adequate building facilities at the branches of the Federal Reserve Banks could not be met because of a statute providing that in no case should the cost of the building proper (exclusive of vaults, permanent equipment, furnishings, and fixtures) exceed $250,000. To meet the most urgent needs, the law was amended on July 30, 1947, to provide that this limit should not apply as long as the aggregate of such costs incurred thereafter with the approval of the Board was not in excess of 10 million dollars. This amount, however, has been inadequate to cover branch building programs which are necessary to efficient operation. Therefore, the Board has recommended legislation to increase the aggregate amount which may be used for this purpose.

RESERVE BANK OPERATIONS

Volume of operations. On the whole, the volume of operations in the principal departments of the Federal Reserve Banks increased over the level of 1948. Most of the normal peacetime operations were in excess of previous years, but continuing the earlier post-war decline there was further contraction in operations as fiscal agents for the United States Treasury and other Government agencies. Table 5 on page 85 shows the volume of operations in the principal departments of the Federal Reserve Banks for each of the past five years.

Discounts and advances were less numerous in 1949 than in 1948, but greater in amount. The number of banks accommodated through rediscounts or advances in 1949 was 1,006 as compared with 1,166 in 1948. The amount of industrial loans declined but the number increased somewhat, and at the end of the year 1949 outstanding loans were higher than at any year-end since 1944. The volume of currency and coin received and counted and of checks handled set new records in 1949, although a decline was shown in the aggregate amounts of the currency and checks handled. For the fourth consecutive year there was a decrease in the number and aggregate amount of issues, redemptions, and exchanges of United States Government securities. Transfers of funds increased in both number and amount.

Earnings and expenses. Current earnings and expenses of the various Federal Reserve Banks in 1949 are given in detail in Table 6 on pages 86-87, and a condensed annual statement since 1914 for all the Reserve Banks combined is shown in Table 7 on pages 88-89. The table on page 62 summarizes the distribution of Federal Reserve Bank earnings for the year 1949 in comparison with 1948.

Current earnings of 316 million dollars in 1949 were 12 million more than in 1948. Current expenses increased by somewhat over 4 million dollars, and current net earnings were 239 million in 1949, as compared with 231 million for the previous year.

Net additions to current net earnings, resulting for the most part from net profits on the sale of Government securities, aggregated 28 million dollars as compared with 6 million in 1948. Transfers to reserves for contingencies totaled 40 million dollars, about the same as in 1948, and payments to the United States Treasury as

EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS
1949 AND 1948

[In thousands of dollars]

Item	1949	1948
Current earnings	316,537	304,161
Current expenses	77,478	72,710
Current net earnings	239,059	231,451
Additions to current net earnings	31,664	6,517
Deductions from current net earnings	3,392	414
Net additions	28,272	6,103
Transferred to reserves for contingencies	40,394	40,421
Paid U. S. Treasury (interest on outstanding F. R. notes)	193,146	166,690
Net earnings after reserves and payments to U. S. Treasury	33,791	30,443
Dividends paid	12,329	11,920
Transferred to surplus (Sec. 7)	21,462	18,523

interest on outstanding Federal Reserve notes amounted to 193 million, or 26 million more than in 1948. The 6 per cent dividend to member banks on their holdings of capital stock of the Federal Reserve Banks, as required by the Federal Reserve Act, amounted to 12 million dollars. Remaining net earnings of 21 million dollars were transferred to the Section 7 surplus account.

Holdings of loans and securities. The table on page 63 presents a comparison of average holdings, earnings, and rates of interest on holdings of loans and securities of the Federal Reserve Banks during each of the past four years. Continuing the trend of the past few years, average holdings of United States Government securities in 1949 declined 2 billion dollars, the largest decrease for any year since 1946, the peak year. This reduction in Reserve Bank credit was made possible largely by decreases in the requirements for member bank reserves and in the volume of currency in circulation, which supplied member banks with additional reserve funds. Earnings on holdings of Government securities increased somewhat, despite the decrease in holdings, reflecting an increase from 1.39 per cent for 1948 to 1.60 per cent for 1949 in the average rate of interest received. Holdings of discounts and advances and of industrial loans, and earnings from both these sources, declined from 1948.

Reserve Bank Earnings on Loans and Securities, 1946–49

[Dollar amounts in thousands]

Item and year	Total	Discounts and advances	Acceptances purchased	U. S. Government securities direct and guaranteed	Industrial loans
Average daily holdings:					
1946	$23,570,260	$310,308	$8,457	$23,250,195	$1,300
1947 [1]	22,552,491	218,755	384	22,331,740	1,612
1948 [1]	21,841,623	330,706	....	21,509,321	1,596
1949 [1]	19,804,711	231,201	....	19,572,664	846
Earnings:					
1946	149,703	2,497	43	147,125	38
1947	157,823	2,195	4	155,564	60
1948	303,316	4,371	....	298,903	42
1949	315,754	3,472	....	312,241	41
Average rate of interest (per cent):					
1946	0.64	0.80	0.51	0.63	2.90
1947	0.70	1.00	1.01	0.70	3.75
1948	1.39	1.32	....	1.39	2.64
1949	1.59	1.50	....	1.60	4.85

[1] Based on holdings at opening of business.

Foreign transactions. Continuing the upward trend which began in the latter part of 1947, total dollar and gold assets held by the Federal Reserve Banks for foreign account increased by about 700 million dollars net during 1949 to nearly 5 billion dollars. This net increase took the form largely of earmarked gold and dollar deposits, which rose by 482 million dollars and 124 million dollars, respectively. Gold and dollar assets held by the Federal Reserve Bank of New York for the International Bank for Reconstruction and Development and the International Monetary Fund, on the other hand, declined by a moderate amount. This contrasted with a sharp net rise in 1947 and a relatively moderate increase in 1948. Combined assets held for foreign and international account amounted to around 8 billion dollars at the end of the year, or close to the peak reached in February 1947.

The demand for loans on gold by foreign central banks showed a decline during the year. While outstanding loans had reached a peak of nearly 260 million dollars in August 1948, by the end of 1949 the total had receded to slightly less than 70 million. Loans had been outstanding to five central banks at the end of 1948; three of these banks retired their loans in full during 1949 and the other two are expected to liquidate their indebtedness within several months. New loans were made to two central banks, one of which had reduced its indebtedness by the end of the year, while the other was still indebted for the full amount. The policy with respect to loans on gold remains unchanged. It contemplates short-term advances for temporary, usually seasonal, dollar deficiencies; interest is at the discount rate of the Federal Reserve Bank of New York, which was 1½ per cent throughout 1949.

One regular foreign central bank account was opened during the year, and another account was opened by the Federal Reserve Bank of New York acting as fiscal agent of the United States. On the other hand, one wartime account which had been maintained for a foreign government was closed.

The Federal Reserve Bank of New York, in its capacity as United States depositary for the International Bank and the International Monetary Fund, continued to perform a variety of services for those institutions, including the earmarking of gold, handling investments in United States Government securities, and holding securities in custody.

The Federal Reserve Bank of New York, as fiscal agent of the United States, continued to operate the United States Stabilization Fund in accordance with authorization and instructions from the Treasury Department. Its fiscal agency function for the Office of Alien Property of the Department of Justice in the administration of foreign funds control, however, was terminated on May 31, 1949.

Bank premises. In May 1949 the Board modified its postwar policy with respect to construction work at Federal Reserve Banks and branches to permit alterations and improvements necessary to provide satisfactory working conditions.

The Federal Reserve Bank of San Francisco was authorized to let contracts for buildings to house its Portland and Seattle Branches, which are presently occupying leased quarters. Upon occupancy of these two new buildings, all Reserve Banks and branches will be housed in their own buildings for the first time in the history of the System. Authorization was given the Federal Reserve Bank of Chicago to erect an addition to and make substantial alterations in the Detroit Branch building.

Other building projects authorized by the Board in 1949 were the construction of a garage and other improvements to the St. Louis property of the Federal Reserve Bank of St. Louis and extension of the mezzanine floor and alterations in its Little Rock Branch building, modernization and extension of the air conditioning system in the head-office building of the Federal Reserve Bank of Kansas City, and air conditioning and other improvements to the building of the Baltimore Branch of the Federal Reserve Bank of Richmond.

Purchase of a lot forming a part of the land upon which the St. Louis Bank building is situated was consummated early in 1950. A strip of land contiguous to the Pittsburgh Branch property was purchased by the Federal Reserve Bank of Cleveland, with a view to constructing an addition to the present building. Property which had been acquired in 1945 as a building site for an annex to the Pittsburgh Branch was disposed of at a small profit.

Preparation of detailed plans and specifications was authorized during 1949 for an addition to the building of the Federal Reserve Bank of Richmond, for a new building to house the Jacksonville Branch of the Federal Reserve Bank of Atlanta, and for an addition to the Los Angeles Branch quarters of the Federal Reserve Bank of San Francisco.

The cost of bank premises owned by the Federal Reserve Banks is given in Table 9 on page 92.

RESERVE BANK PERSONNEL

Chairmen and Deputy Chairmen. One of the three Class C directors appointed by the Board of Governors for each Federal Reserve Bank is designated annually to serve as Chairman of the

Board of Directors and as Federal Reserve Agent, and another Class C director is appointed annually as Deputy Chairman. A list of the Chairmen and Deputy Chairmen is shown on page 122.

The Chairmen and Deputy Chairmen at the Federal Reserve Banks were redesignated to serve as such for the year 1949, except for the following changes:

Warren F. Whittier, Agricultural Consultant, Chester Springs, Pennsylvania, who had served as a Class C director of the Federal Reserve Bank of Philadelphia since December 2, 1939, and as Deputy Chairman since July 1, 1941, on March 18, was designated Chairman and Federal Reserve Agent for the remaining portion of the year 1949.

C. Canby Balderston, Dean, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia, Pennsylvania, who had served as a Class C director of the Federal Reserve Bank of Philadelphia since April 8, 1943, on March 18, was appointed Deputy Chairman for the remaining portion of the year 1949.

A. Z. Baker, Chairman of the Board, The Cleveland Union Stock Yards Company, Cleveland, Ohio, who had been a Class C director of the Federal Reserve Bank of Cleveland since August 8, 1942, was appointed Deputy Chairman for the year 1949.

Charles P. McCormick, President and Chairman of the Board, McCormick & Company, Inc., Baltimore, Maryland, who had been a Class C director of the Federal Reserve Bank of Richmond since August 31, 1939, and Deputy Chairman since January 1, 1947, was designated Chairman and Federal Reserve Agent for the year 1949.

John B. Woodward, Jr., President and General Manager, Newport News Shipbuilding and Dry Dock Company, Newport News, Virginia, was appointed Deputy Chairman of the Federal Reserve Bank of Richmond for the year 1949, after having been appointed a Class C director, effective January 1, 1949, for the unexpired portion of the term ending December 31, 1949.

Rufus C. Harris, President, The Tulane University of Louisiana, New Orleans, Louisiana, who had been a Class C director of the Federal Reserve Bank of Atlanta since January 28, 1938, was appointed Deputy Chairman for the year 1949.

F. J. Lunding, President, Jewel Tea Company, Inc., Barrington, Illinois, was appointed Deputy Chairman of the Federal Reserve Bank of Chicago for the year 1949, after having been appointed a Class C director for the term beginning January 1, 1949.

Directors. A list of the directors of the Federal Reserve Banks and branches as of the close of the year is shown on pages 123-35.

The Board of Governors made the following appointments of new directors either for terms beginning January 1, 1949, or to fill vacancies during the year:

Class C Directors. Philip T. Sharples, Chairman, The Sharples Corporation, Philadelphia, Pennsylvania, was appointed a Class C director of the Federal Reserve Bank of Philadelphia for the unexpired portion of the term ending December 31, 1951. Mr. Sharples assumed his duties on June 9.

L. L. Rummell, Dean, College of Agriculture, The Ohio State University, Columbus, Ohio, was appointed a Class C director of the Federal Reserve Bank of Cleveland for the term beginning January 1, 1949.

John B. Woodward, Jr., President and General Manager, Newport News Shipbuilding and Dry Dock Company, Newport News, Virginia, was appointed a Class C director of the Federal Reserve Bank of Richmond, effective January 1, 1949, for the unexpired portion of the term ending December 31, 1949.

Paul E. Reinhold, President, Foremost Dairies, Inc., Jacksonville, Florida, was appointed a Class C director of the Federal Reserve Bank of Atlanta for the term beginning January 1, 1949.

F. J. Lunding, President, Jewel Tea Company, Inc., Barrington, Illinois, was appointed a Class C director of the Federal Reserve Bank of Chicago for the term beginning January 1, 1949.

Branch Directors. Ernest H. Hahne, President, Miami University, Oxford, Ohio, was appointed a director of the Cincinnati Branch of the Federal Reserve Bank of Cleveland for the term beginning January 1, 1949.

Sidney A. Swensrud, President, Gulf Oil Corporation, Pittsburgh, Pennsylvania, on February 3, was appointed a director of the Pittsburgh Branch of the Federal Reserve Bank of Cleveland for the unexpired portion of the term ending December 31, 1949.

John W. Taylor, President, University of Louisville, Louisville, Kentucky, was appointed a director of the Louisville Branch of the Federal Reserve Bank of St. Louis for the term beginning January 1, 1949.

James A. McCain, President, Montana State University, Missoula, Montana, was appointed a director of the Helena Branch of the Federal Reserve Bank of Minneapolis for the term beginning January 1, 1949.

G. Norman Winder, Rancher, Craig, Colorado, was appointed a director of the Denver Branch of the Federal Reserve Bank of Kansas City for the term beginning January 1, 1949.

Change in First Vice President. Mr. Charles B. Dunn resigned as First Vice President of the Federal Reserve Bank of Chicago effective November 1. Mr. Dunn had served as General Counsel of the Federal Reserve Bank of Chicago from January 1, 1934 to February 26, 1942, when he was appointed Vice President as well as General Counsel. He was appointed First Vice President effective October 25, 1945.

Staff. At the end of 1949, the total number of officers and employees of the twelve Federal Reserve Banks and their twenty-four branches was 17,967, representing a decline of 1,120 since the end of 1948. The total Reserve Bank personnel has declined each year since 1943 when it was at its peak owing to the great expansion in the volume of operations resulting from the war. The total number of officers and employees of the Reserve Banks and branches at the end of each year beginning with 1942 was as follows:

1942	19,972	1946	21,430
1943	24,741	1947	19,364
1944	24,442	1948	19,087
1945	23,522	1949	17,967

BOARD OF GOVERNORS—STAFF

Death of member of the Board. Lawrence Clayton, who had been a member of the Board of Governors since February 1947, died on December 4, 1949. Mr. Clayton first became associated with the Board of Governors in December 1934, as Assistant to the Chairman of the Board, which position he held until the beginning of 1945 when he resigned to engage in private business.

Staff. On December 31, 1949, the Board's staff, exclusive of those on leave without pay, numbered 540, as compared to 517 at the end of 1948.

Frank A. Southard, Jr., resigned as Associate Director of the Board's Division of Research and Statistics effective February 28, 1949, to accept the appointment as United States Executive Director of the International Monetary Fund. Mr. Southard became associated with the Board on August 16, 1948, having previously served as Director of the Office of International Finance of the Treasury Department.

G. Howland Chase was appointed by the Board as Assistant Solicitor effective June 26, 1949. Mr. Chase became associated with the Board's Legal Division on May 2, 1932, and served in that Division until December 7, 1948, when he was appointed Attorney in the Office of the Solicitor.

Woodlief Thomas, who had been Director of the Board's Division of Research and Statistics since February 1945, was appointed to the newly created position of Economic Adviser to the Board, effective October 1, 1949. With the exception of a period during 1929 and 1930 when Mr. Thomas served with the Transfer Commission (Office for Reparations Payments) in Berlin, Germany, he has been engaged in research work for the Federal Reserve System since 1920, serving at various times with the Federal Reserve Bank of Philadelphia, the Federal Reserve Bank of New York, and the Board of Governors.

Ralph A. Young was appointed to succeed Mr. Thomas as Director of the Division of Research and Statistics. Mr. Young, who had been Associate Director of the Division since December 1947, joined the Board's staff as Assistant Director of the Division of Research and Statistics in March 1946, prior to which he had served for a number of years as Director of the Financial Research Program of the National Bureau of Economic Research and concurrently as Professor of Economics at the Wharton School of Business and Finance of the University of Pennsylvania.

BOARD OF GOVERNORS—INCOME AND EXPENSES

The following table shows the income and expenses of the Board for the year 1949:

OPERATING SURPLUS, January 1, 1949		$ 311,169.60	
Adjustment in 1949 applicable to preceding years		1,496.71	$ 312,666.31
INCOME:			
Assessments on Federal Reserve Banks		3,242,500.00	
Sale of *Federal Reserve Bulletin*		13,673.02	
Sale of other publications		21,766.49	
Miscellaneous		4,618.74	3,282,558.25
			3,595,224.56
EXPENSES:			
Salaries		2,262,124.51	
Retirement contributions—regular		171,895.54	
Retirement contributions—special		20,884.72	
Traveling expenses		179,669.44	
Postage and expressage		10,750.46	
Telephone and telegraph		66,809.55	
Printing and binding		144,576.61	
Stationery and supplies		27,128.85	
Furniture and equipment, including rental		47,896.64	
Books and subscriptions		11,556.71	
Heat, light, and power		33,045.68	
Repairs and alterations (building & grounds)		7,399.19	
Repairs and maintenance (furniture & equipment)		6,107.50	
Medical service and supplies		1,521.87	
Insurance		4,622.40	
Miscellaneous:			
Surveys of consumer finances	$162,571.92		
Cafeteria (net)	34,460.10		
Legal and consultant fees and expenses	26,490.85		
All other	53,104.71	276,627.58	3,272,617.25
OPERATING SURPLUS, December 31, 1949			$ 322,607.31

In addition to the foregoing, the Board made certain expenditures on a reimbursable basis for which it received reimbursements in 1949 as follows:

Printing Federal Reserve notes	$4,221,433.00
Leased wire service (telegraph)	102,963.05
Leased telephone lines	9,684.00
Federal Reserve Issue and Redemption Division (Comptroller of the Currency)	98,550.20
Miscellaneous	24,859.57

The accounts of the Board for the year 1949 were audited by the Auditor of the Federal Reserve Bank of Boston, who certified them to be correct.

RESEARCH AND ADVISORY SERVICES

As in former years, the Board continuously studied the interrelationships between the banking and monetary situation and general economic developments. The areas analyzed included changes in both business and consumer incomes and expenditures, employment and unemployment, production and prices, Treasury financing, business financing and the market for equity capital, commercial bank loans, and the general financial position of business and consumers. Close attention was also given to economic and financial developments in foreign countries, including the relationships between developments in the United States and abroad.

From time to time members of the Board supplied Congressional committees with information concerning banking and monetary matters related to Federal Reserve responsibilities. Members of the Board's staff gave technical assistance to several Congressional committees engaged in investigating special monetary and economic problems, and participated in numerous governmental and private conferences relating to current and prospective economic conditions. Staff members also served on interdepartmental committees concerned with analyzing a wide range of economic developments and with improving and extending statistical and other information of value in analyzing economic tendencies. Among the projects with which the staff helped in this manner were the "Standard Industrial Classification Manual for Nonmanufacturing Industries," sponsored and published by the Bureau of the Budget; a discussion and training program for foreign experts, sponsored by the Organization for European Economic Cooperation, the Economic Cooperation Administration, and the Bureau of Labor Statistics; and a study of appropriate standards for industrial production indexes, sponsored and published by the United Nations.

The Board continued its sponsorship of the Survey of Consumer Finances—a comprehensive study in the field of noncorporate private finance. These surveys, made annually since 1946, have provided significant data on the distribution of consumer incomes, ownership and use of liquid and nonliquid assets, consumer saving, and housing expenditures and finance. The surveys have also provided information concerning the attitudes of consumers toward business conditions in general, their own financial status, and their potential expenditures for houses, automobiles, and other types of durable goods. Results of the 1949 survey, conducted for the Board by the Survey Research Center of the University of Michigan, were published in the *Federal Reserve Bulletin* in a series of articles beginning in June 1949. Results of a supplementary survey, conducted in July 1949, were published in the October issue of the *Bulletin*. A fifth annual survey was begun in January 1950.

Work has continued on the project to develop estimates of money-flows for major sectors of the economy. Substantial progress was made in bringing accounts for most sectors up to date. For the banking sector a monthly series relating assets of the entire banking system to the money supply was initiated and since June 1949 has been released currently and later published in the *Federal Reserve Bulletin*.

Considerable progress was made during the year in assembling, revising, and tabulating an historical statistical series of the principal assets and liabilities of all banks in the United States, by class of bank and by State.

A general revision of the Board's Index of Industrial Production was undertaken in order to utilize new information provided by the 1947 Census and other sources. Further refinement of the Board's statistics on consumer credit was undertaken in 1949.

In December the Board published a pamphlet, *Distribution of Bank Deposits by Counties,* which gives separately the demand and the time deposits of individuals, partnerships, and corporations as of June 30, 1949. A similar pamphlet was last published in July 1948 with data as of December 31, 1947. The deposit figures supplement other information available on a county basis for analyzing local business conditions. Data for the latest pamphlet were prepared from bank and branch condition reports, which were obtained by the Comptroller of the Currency from national banks, by the Federal Reserve Banks from State member banks, and by the Federal Deposit Insurance Corporation from nonmember banks. Prior to 1949, branch condition reports were last obtained in 1941, and then for member banks only.

In October the Board issued an historical supplement to its monthly *Federal Reserve Chart Book on Bank Credit, Money Rates, and Business*. The book, as enlarged in a substantially revised edition issued in March 1950, contains 113 pages of charts going back to at least 1919 in most cases and for longer periods in other cases.

The Board continued to work on problems involving United States policy decisions in the international economic and financial field. A large part of this work was related to the activities of the National Advisory Council on International Monetary and Financial Problems of which the Chairman of the Board is a member, and was carried out in close collaboration with the other agencies represented on the Council.

Representatives of the Federal Reserve System participated in the Second Conference of Central Bank Experts of the Western Hemisphere held in Santiago, Chile, in December, and the Board continued to cooperate in projects of an international nature by supplying members of its staff for assignments abroad. These included assisting the Government of Ceylon to prepare central bank legislation, giving advice on policy to the new Central Bank of the Philippines, making a preliminary survey of financial conditions in Korea for the Economic Cooperation Administration, assisting the International Bank for Reconstruction and Development to analyze economic and financial conditions in Germany and in Chile, and helping to prepare a report on the fiscal problems of Guatemala for the Government of that country. Members of the Board's staff assisted the Economic Cooperation Administration in work on specific problems from time to time and attended the meetings of ECA Finance Officers in Paris in April and November. The Director of the Board's Division of Research and Statistics spent three months in Europe visiting central banks and studying economic and financial conditions abroad. The Board facilitated the work of numerous officials of foreign central banks and governments and other persons who came to the United States on official business or to study American banking policies and practices or American methods of analyzing economic developments.

PUBLICATIONS AND RELEASES

There was a continuing demand for the Board's publications and releases during 1949. The volume of requests for the booklet entitled, THE FEDERAL RESERVE SYSTEM—ITS PURPOSES AND FUNCTIONS, made a second printing necessary. The mailing list for articles relating to surveys of consumer finances expanded greatly, and several periodic releases were initiated. In addition to regulations and various reprints, the following publications were issued.

FEDERAL RESERVE BULLETIN. Issued monthly.

FEDERAL RESERVE CHARTS ON BANK CREDIT, MONEY RATES, AND BUSINESS. Issued monthly.

STATE BANK MEMBERS AND NONMEMBER BANKS THAT MAINTAIN CLEARING ACCOUNTS WITH FEDERAL RESERVE BANKS. Complete list in February with monthly supplements.

LIST OF STOCKS REGISTERED ON NATIONAL SECURITIES EXCHANGES. Supplements in February, May, August, and November.

MEMBER BANK CALL REPORT. Three issues, one each in April, July, and September.

BANKING STUDIES (1941). Reprinted in March.

AMENDMENTS TO RULES OF ORGANIZATION AND RULES OF PROCEDURE (Board of Governors of the Federal Reserve System). Published in June.

RETAIL CREDIT SURVEY—1948. Published in July.

THIRTY-FIFTH ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. Published in August.

PAR LIST. Complete list in August with monthly supplements.

HISTORICAL SUPPLEMENT TO FEDERAL RESERVE CHARTS ON BANK CREDIT, MONEY RATES, AND BUSINESS. Published in October.

REPLY OF THE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (To the Questionnaire of the Joint Congressional Committee on the Economic Report). Published in November.

THE FEDERAL RESERVE SYSTEM—ITS PURPOSES AND FUNCTIONS (1947). Reprinted in December.

DISTRIBUTION OF BANK DEPOSITS BY COUNTIES, June 30, 1949. Published in December.

FEDERAL RESERVE MEETINGS

The Federal Open Market Committee met in Washington on February 28, March 1, May 3, June 28, August 5, and December 13, 1949, and the executive committee of the full Committee met from time to time during the year. Under the provisions of Section 12A of the Federal Reserve Act, the Federal Open Market Committee has responsibility for determining the policies under which the open market operations of the Reserve Banks will be carried out. A record of the actions taken by the Committee on questions of policy will be found on pages 110-18 of this report.

A Conference of the Chairmen of the Federal Reserve Banks was held on May 28-30, 1949, and was attended by members of the Board of Governors.

The Conference of Presidents of the Federal Reserve Banks held meetings on February 25-26, May 2, November 2-4, and December 14, and the Board of Governors met with the Presidents on February 28, May 3, and December 14.

Meetings of the Federal Advisory Council were held on February 13-15, May 15-17, September 18-20, and November 13-15. The Board of Governors met with the Council on February 15, May 17, September 20, and November 15. The Council is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with and advise the Board in all matters within the jurisdiction of the Board.