MONTHLY REVIEW

After three consecutive record years, District furniture makers are starting 1965 with more orders than ever.

FEDERAL RESERVE BANK OF RICHMOND JANUARY 1965

FIFTH DISTRICT 1964

During 1964, business activity rose to record highs in the Fifth District, as it did in most of the country. Nearing the end of a fourth year, however, the upswing in the District displayed some significant changes from previous growth patterns. Even though business had been expanding for many months, the general rate of growth was moderately higher than in the previous year. Many of the District's principal manufacturing industries established new records by substantial margins, and most nonmanufacturing enterprises surpassed previous highs. Nonfarm employment rose nearly 3% during the year while unemployment declined. More new incorporated businesses were started than in any year since 1960. Total new investment proceeded at a rate that subsequent statistics will undoubtedly reveal as an all-time high.

While favorable developments were the rule, they were not universal. Early in the year, tobacco manufacturing faced a sharp drop in demand when a report dealing with possible adverse effects of its products was issued by the Surgeon General of the United States. Following the initial impact, however, tobacco sales gradually recovered to approximately the prior year's level. Although current construction activity rose to record proportions, forward indicators such as contract awards and building permits assumed a pattern of high-level fluctuation, apparently ending the uptrend of the prior three years but without suggesting a downturn. In bituminous coal, the year was regarded as generally satisfactory, although demand fell somewhat short of industry expectations.

Population and Labor During 1964 population continued to grow slightly faster in the District than in the nation. By the end of the year District residents numbered nearly 18 million, of which more than one fourth were North Carolinians, just under one fourth were Virginians, almost one fifth were Marylanders, something over one seventh were South Carolinians, about one tenth were West Virginians, and nearly one twentieth were residents of the District of Columbia. Population growth during 1964 was well above the national rate in Maryland, Virginia, and South Carolina, about even with it in North Carolina, and below it in the District of Columbia. West Virginia continued to lose population, as it has since 1950.

Growth in the District labor force slowed somewhat as the year progressed, but employment continued to advance at a good rate, and unemployment declined. District joblessness during 1964 averaged some 6% below year-earlier levels, and District unemployment rates were typically about one sixth lower than the national rate. Insured unemployment declined more than seasonally during the first half of the year and behaved about seasonally thereafter. District rates of insured unemployment were among the lowest in the nation. West Virginia's rate, consistently the highest in the District, declined steadily from levels well above the national average early in the year to below the national figure during the fourth quarter. Virginia's insured unemployment rate, which declined in the course of the year from just under 3.0% in January and February to as low as 0.7% in October, was usually the lowest in the nation or tied for lowest.

Need for Skills Noted The tone in the markets for skilled labor changed gradually during the year, reflecting stronger demand. After midyear, reports of labor shortages became more frequent. They appeared first in construction, then in the durable goods sector of manufacturing, and finally in nondurable goods industries. Despite the scarcity of workers, employment increased significantly. The workweek expanded about seasonally during the spring and summer, much as it did in 1963. Increased pay scales reflecting the labor shortage were reported in the second half of the year by spokesmen for the local construction industry. Regional wage data are incomplete, but it seems likely that construction workers' wages rose about the same in the District as in the nation, one to four cents per hour monthly from July on.

Labor supplies also tightened during the year in metals, machinery, and equipment industries, many of which are located in Maryland. There the workweek in durable goods industries grew from 40 hours in January to over 43 hours in September before declining in October. The workweek in primary metals showed the sharpest increase, lengthening

MONTHLY REVIEW

FEDERAL RESERVE BANK OF RICHMOND

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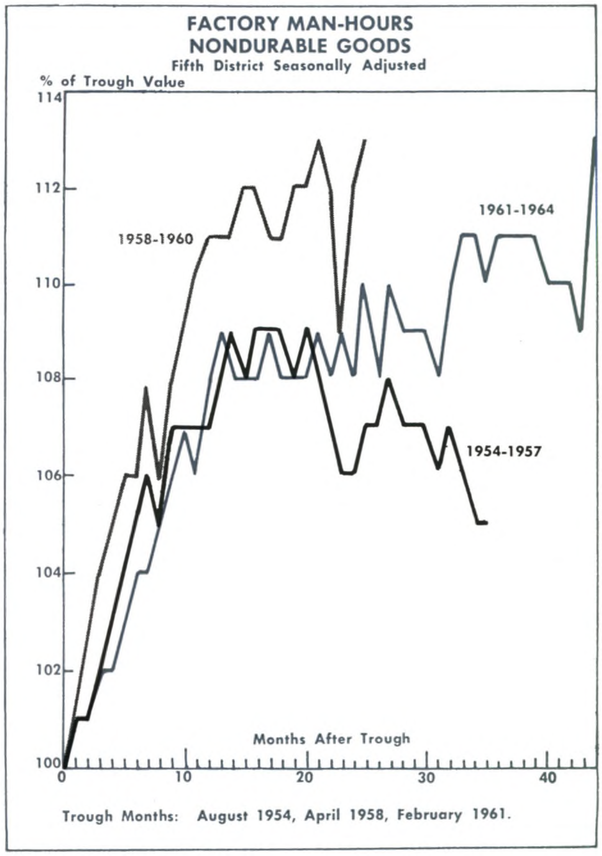
from less than 40 hours in January to over 46 hours in September before dropping to around 42 hours in October. Average hourly earnings also rose during the year as overtime pay increased.

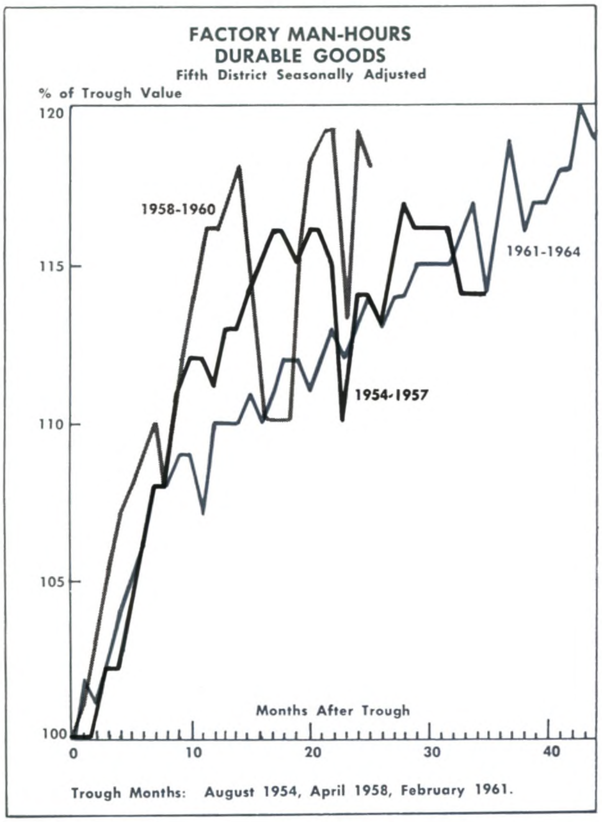
A rising demand for labor was perhaps even more apparent in southern than in northern areas of the District. Among producers of nondurable goods, weekly hours and average hourly earnings rose significantly in textile mills, in apparel plants, in printing and publishing establishments, and in chemical plants. In durable goods other than metals and metal products, weekly hours and hourly earnings advanced strongly during the year in furniture and in stone, clay, and glass industries.

Outside the manufacturing and construction sectors, the evidence of increased labor needs was less pronounced. Mining employment rose only slightly, and the average workweek, which trends upward in the course of each year in response to seasonal forces, apparently increased more than usual last year. In West Virginia mines, the workweek rose from about 38 hours in February (the year's low except for July, when the mines closed down as usual for vacations) to nearly 42 hours in October. Concurrently, average hourly earnings rose some 20 cents. The trade sector of the District economy also displayed some increased manpower needs. Trade employment rose nearly 2% during the year, and pertinent statistics, although not available District-wide, suggest that pay scales rose some 5% while the workweek remained largely unchanged.

Major Sectors Show Strength This and the remaining sections deal with 1964 developments in major sectors of the Fifth District economy. The charts used to illustrate these developments have been designed specifically to set forth 1964 progress in perspective against previous growth patterns. The chart at the foot of this page is a typical example, and those that follow are similarly organized. The blue line on the chart traces the growth of man-hours in District durable goods factories from the low point, or trough, of the most recent recession through the latest month for which data are available. It begins, therefore, with February 1961 and ends with October 1964. The gray line traces the movement of durable goods man-hours in the previous business upswing, from the recession low in April 1958 to the peak of the subsequent upswing in May of 1960. The black line shows the same information for the period from the trough in August 1954 to the peak in July 1957. As the blue line indicates, District durable goods man-hours were 14% above the February 1961 level as 1964 began and rose an additional five or six percentage points during the year.

Several aspects of this chart, some of which apply to the other charts also, are of particular interest. First, monthly variations have been smaller in the current growth period than in the two previous periods of advancing business. Whatever the reasons may be, longer growth has been associated with greater stability. A second noteworthy aspect of this chart, and of the others to a smaller degree, is the rapid, essentially parallel, rise during the first six months or so after each recession low followed by a period of slower growth and more fluctuation. The man-hours chart for durable goods suggests that the two previous periods of initial recovery may have continued at this rapid pace for too long a time and may have overshot the trend of normal growth. This might partially explain the sharp downward adjustments and the wide fluctuations which characterized the later stages of the two previous growth periods. At the beginning of the current upswing, on the other hand, man-hours rose rapidly for the first eight months, apparently reaching a normal growth line, which they have now followed for some three years with relatively minor fluctuations. Monthly variations became somewhat larger during 1964 but were small, nevertheless, by comparison





with those of the previous periods charted. Growth has now maintained a rate of approximately 3% per year over a period of three years.

Durables Show Mixed Trends Labor utilization in District durable goods industries is divided surprisingly evenly between eight major groups with primary metals and furniture accounting for slightly larger shares than the rest, and over-all growth during 1964 concealed some diversity. A sharp rise occurred in primary metals during the second half of 1964 after some nine months of relatively little change. The increase in the machinery industry, steady but moderate during 1963 and most of 1964, accelerated considerably last fall. Transportation equipment man-hours continued to rise gradually from 1963 to about the middle of 1964, declined as a result of model changing in late summer and strikes in the early fall, then rose sharply again toward the end of the year. In the furniture industry, with 1964 the third year of strong, steadily rising demand, man-hours reached a high level in March following an unusually large volume of spring business and stayed close to that mark for the rest of the year. Following highly successful fall markets, the rise resumed and probably reached a new high by the year's end although the statistical proof is not yet available.

In other durable goods factories during most of 1964, man-hours followed a rather neutral course. Stone, clay, and glass plants reached the year's highest labor utilization levels during the spring. In fabricated metals the second half of 1964 brought slight declines from near-record levels maintained since the middle of the previous year. Electrical equipment followed much the same pattern, trending gradually downward after a first quarter at record levels; but a sharp upturn in October suggested possible new highs toward the end of the year. Lumber industry man-hours, at peak levels in February and March, declined unevenly for the rest of the year.

Nondurable Goods Unlike the durable goods sector where several industries employ nearly equal quantities of labor, the District's nondurables sector is dominated by textile mills which account for more than two fifths of all man-hours. Foods, apparel, and chemicals together make up another two fifths. Other nondurables, chiefly printing, paper, and tobacco, comprise the remaining one fifth.

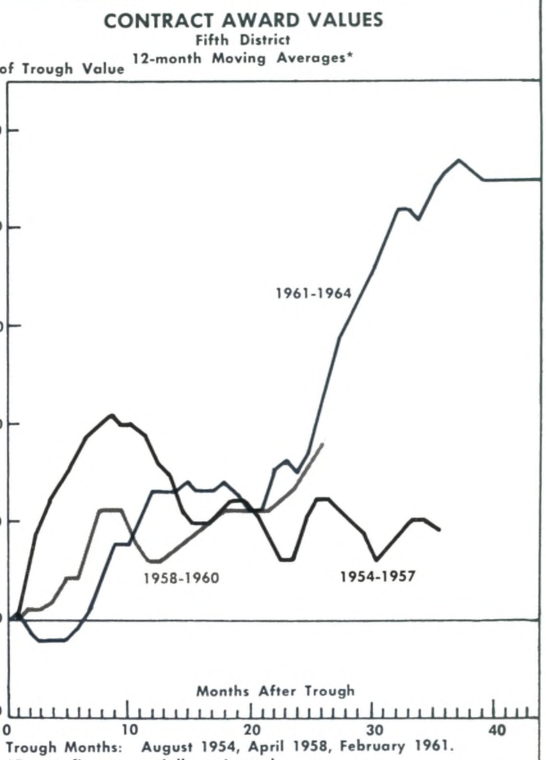
As the chart on this page shows, in nondurables the initial recovery period of the present business upswing lasted about one year. During the second year there was virtually no net growth. The uptrend resumed in the third year and continued in 1964, but with uncharacteristically irregular behavior.

The component series during 1964 fell roughly into three groups. In the first, consisting of textiles, foods, and tobacco manufacturing, man-hours rose to spring highs then declined gradually through the summer and into the early fall. In October, however, textile and tobacco man-hours turned sharply upward. The second group, made up of apparel plants and paper mills, fluctuated mildly during most of 1964 just below high levels reached in December of the previous year. The apparel industry changed course in October, however, and rose to a new high. In the third group, printing plants and chemical factories, man-hours rose slowly and unevenly throughout 1964, much as in the previous year.

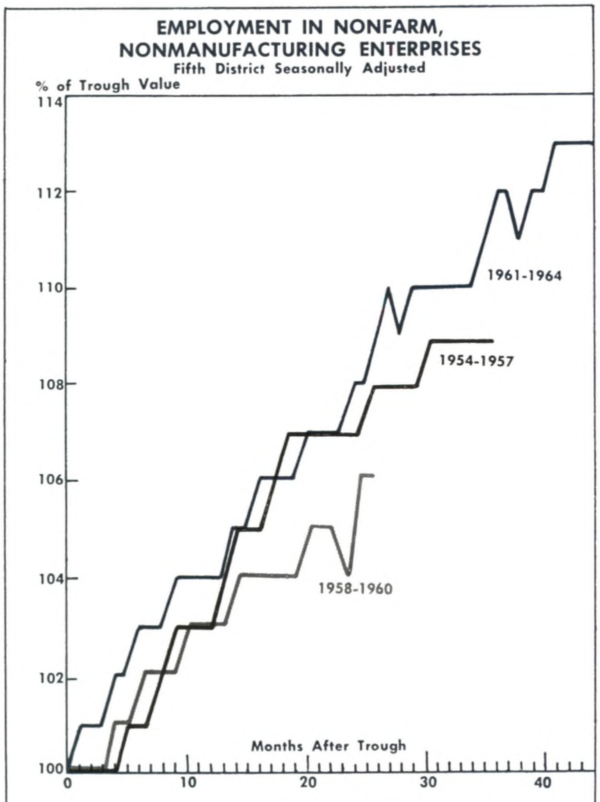
Perhaps the most prominent features of the chart in terms of recent developments are the sharp increases which occurred in October both in 1963 and in 1964. Whereas all major industries except printing participated in the October rise in 1963, the increase a year later was concentrated in textiles, tobacco, chemicals, and apparel.

Textiles Turn a Corner The extensive and diverse textile industry contributed to the District's 1964 business history a most interesting chapter, which can be reviewed here only in outline. At the beginning of the year the industry was marking time, waiting to see what action Congress might take to reduce the domestic price of cotton. For some years a subsidy had held the domestic price 8½ cents per pound higher than the export price. As the year began, Congress was considering a number of proposals designed to offset at least part of the difference between domestic and world prices. The ensuing uncertainty prompted manufacturers all along the line to hold their commitments on cotton and cotton products to a minimum. Prices held firm, but transactions dropped to unusually low levels as fabric buyers refrained from placing their customary volume of forward orders, waiting to see what effect reduced cotton costs would have on fabric prices.

The "farm bill" was passed early in April reducing the domestic price of cotton by 6½ cents a pound, but demand was so strong that cotton goods prices were slow to respond. Shortly, however, a series of price cuts began on some yarns and a few important fabrics and reduced the wholesale price index for cotton broad woven goods in four consecutive months, from April through July. The total decline exceeded 3%. But demand increased steadily, and forward orders moved farther and farther out until by the end of the year a good volume of third-quarter



Trough Months: August 1954, April 1958, February 1961.
*Recent figures partially estimated.
Source: F. W. Dodge Corp.



Trough Months: August 1954, April 1958, February 1961.

1965 production had been sold. Employment and man-hours increased, and the textile component of the national industrial production index rose about 2% per month from July through November. Prices began rising again in August and ended the year close to the levels that had prevailed in the first quarter.

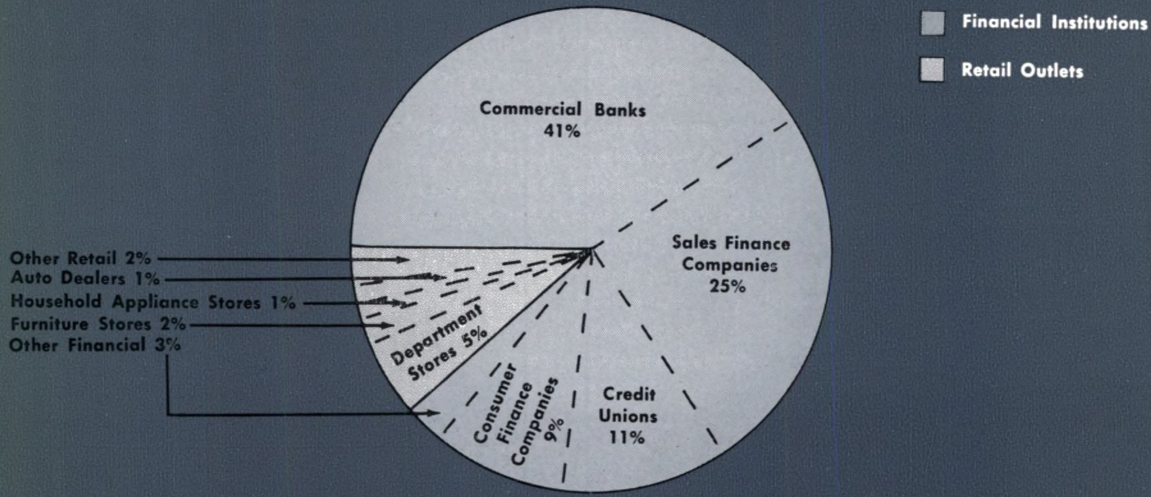
Developments in other phases of the textile industry were equally striking. Wages began rising late in the summer and were up some 5% across the board by midautumn. Earnings reported on third-quarter operations averaged nearly 50% higher than in the previous year. Stock prices advanced, typically from 25% to 40% between the first and third quarters on issues of large cotton goods producers. Investment in highly automated new plants and modern equipment continued at a record pace. As a result, industry capacity, trending downward for a number of years, apparently turned the corner and is rising again.

Nonmanufacturing Sectors The total number of nonagricultural jobs in the District increased by about 150,000 during the year, from around 5,100,000 at the beginning to approximately 5,250,000 at the end. Around 30% of all nonfarm jobs are in manufacturing industries with about twice as many in the nondurable

(Continued on page 8)

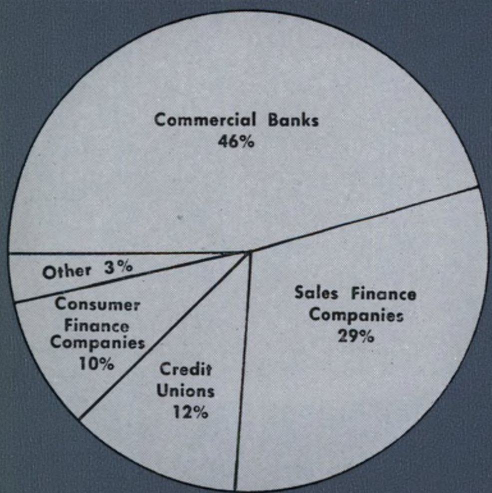
INSTALMENT CREDIT BY HOLDER
(Percentage Distribution)
September 1964

ALL LENDERS



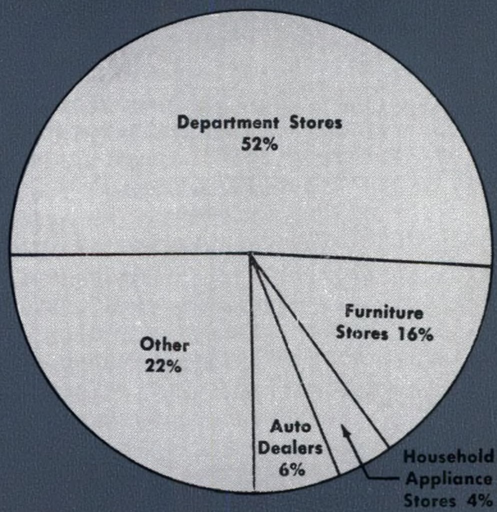
Total Amount Outstanding = $57.4 Billion

FINANCIAL INSTITUTIONS



Amount Outstanding = $50.9 Billion or 89% of All Consumer Instalment Credit Outstanding

RETAIL OUTLETS



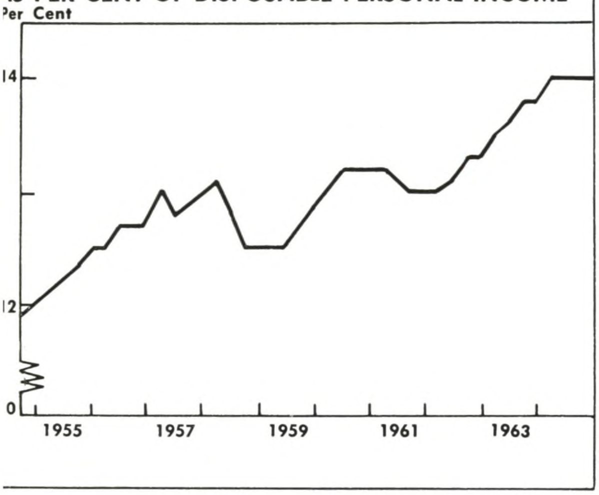
Amount Outstanding = $6.5 Billion or 11% of All Consumer Instalment Credit Outstanding

The graphs above show the relative importance of the various lenders in the consumer instalment credit field. Financial institutions have always been the chief suppliers of this type of credit. Their share of the total has expanded steadily and now amounts to nearly 90%. Retail trade outlets account for the remainder.

Among financial institutions, commercial banks are the most important suppliers of consumer instalment credit, with sales finance companies ranking second. Of the various retail outlets, department stores and mail order houses are by far the most important. Their share of the total instalment credit extended by such outlets has increased 50% in the past ten years.

CONSUMER CREDIT

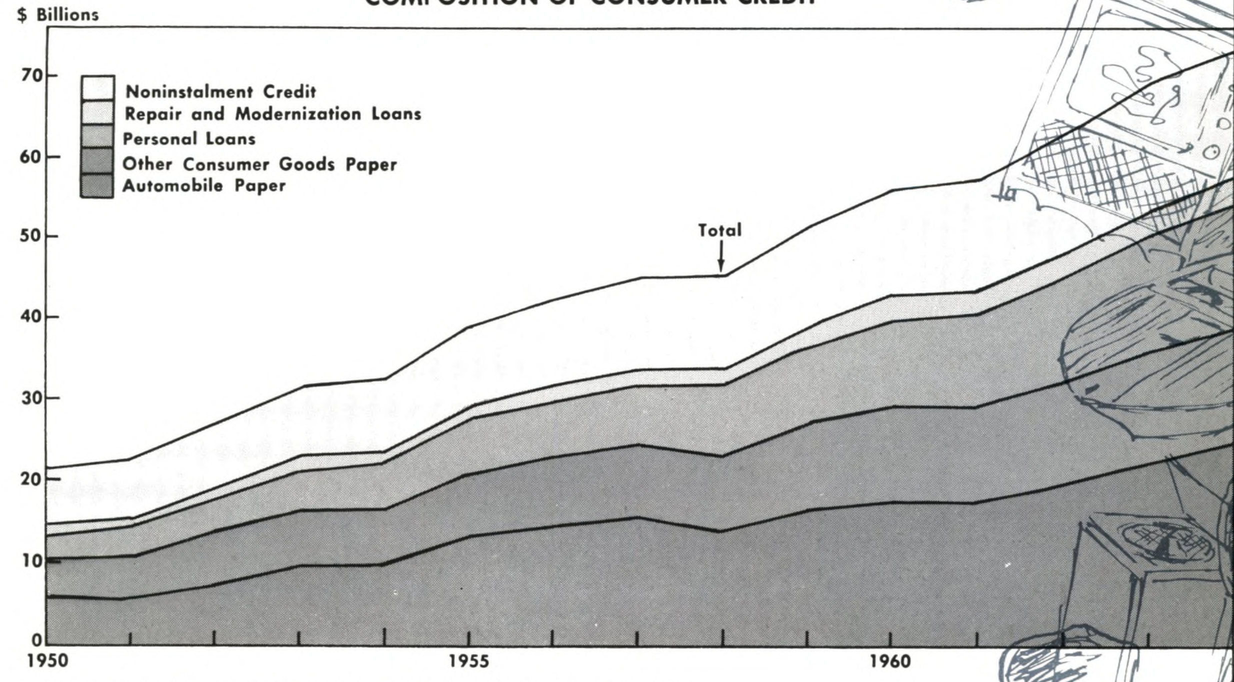
CONSUMER INSTALMENT CREDIT REPAYMENTS
AS PER CENT OF DISPOSABLE PERSONAL INCOME



◀ Repayments on consumer instalment credit have been taking a slowly rising proportion of disposable income in recent years. The fraction rose steadily in 1962 and 1963, reaching an all-time high of 14%. The interruption of this two-year trend in 1964 was due partly to the recent tax cut, which resulted in a large increase in disposable personal income.

▼ Since 1950, total consumer credit has grown at an average annual rate of 9%, or about three times the rate of increase in total public debt. Instalment credit has accounted for about four fifths of the $52 billion increase since that year. Outstanding automobile paper has grown by more than $18 billion, while outstanding instalment debt against other consumer goods has risen $9 billion. The largest relative increase, however, has been in personal instalment loans, which are being used increasingly to finance vacations, education, medical payments, and a variety of expenditures long regarded as inappropriate areas for institutional lending.

COMPOSITION OF CONSUMER CREDIT



Note: Figures are end of year except 1964 which is September data.

ces: Board of Governors of the Federal Reserve System and U. S. Department of Commerce.

(Continued from page 5)

as in the durable goods sector. Among nonmanufacturing jobs, about 30% are in government, 27% in trade, 19% in services, and the rest are mostly in construction, utilities, and financial services.

The chart of growth in nonfarm, nonfactory employment, shown at the bottom of page 5, reflects less business cycle sensitivity than appears in the man-hour charts. Service types of employment have expanded quite steadily in the District since February of 1961, and the growth rate has been quite constant, although there appears to have been some slowing during 1964. Gains in 1964 averaged about 2% over 1963 compared with average increases of 3% and 4% in the two prior years. Employment gains were widespread last year with the sharpest rise occurring in construction. Trade, services, financial enterprises, and transportation, communications, and public utilities continued along previously established lines of growth. Federal, state, and local government jobs in the District numbered about 1,075,000 in October, approximately 3% higher than a year earlier.

Construction Jobs in contract construction increased more than 6% during 1964. Contract awards and building permits, furthermore, maintained substantial margins over comparable 1963 figures. A closer look at these leading indicators, however, suggests a leveling off during the year. Whereas cumulative totals in March and April were running one third or more ahead of 1963, by fall the margin had dropped to about one tenth.

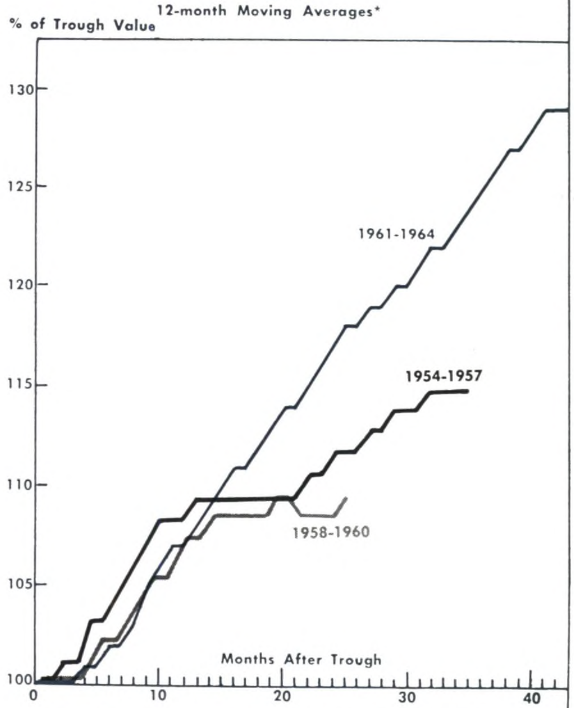
Because these values fluctuate so widely from month to month, the data charted at the top of page 5 have been smoothed out by means of a 12-month moving average. Therefore, each point on the chart is an average of 12 monthly figures extending from six months before the point indicated on the time scale to six months after it. Estimates have been made to supplement the available data in order to bring these averages closer to the end of the year. The figures for the final six months plotted on the chart reflect some influence from these estimates, although the effect on the August figure, when the rise ended, would be very small.

The important role of contract construction in the present upswing is quite apparent. In the first two years of the current period, as in the two previous upswings, contract awards displayed no particular vigor. Whereas previous expansions ended at about that point, the present one continued with contract awards rising rapidly in a sequence of new highs that lasted approximately through the first quarter of the current year. Subsequent evidence suggests that the period in which construction has served as a stimulus to further growth in this expansion period may be coming to an end.

Retail Sales Sales of District retailers increased about 8% during 1964, matching the previous year's growth. Two statistical series substantiate this increase. The first traces monthly growth since the early 1950's in sales of "Group I" retail stores—firms operating at one to ten locations. The second provides monthly estimates of total retail sales since April 1962. The Group I series, which includes more than three fourths of all retail sales and provides the desired historical background, is shown in the chart below.

The values charted are 12-month moving averages to smooth out seasonal and random fluctuations. The chart shows the remarkably steady rise maintained by retail sales during the current upswing. In each of the previous periods, some 12 months of expansion were followed by a period of virtually no change. The present rise, on the other hand, has proceeded

SALES OF GROUP I RETAIL STORES
Fifth District
12-month Moving Averages*



Trough Months: August 1954, April 1958, February 1961.
*Recent figures partially estimated.

without interruption for more than 40 months. Although the moving average was the same in each of the final three months charted (29% above the level at which the upswing began), actual monthly values of both "Group I" and "all stores" sales have been well above year-earlier levels. Department stores, which represent less than 10% of total retail trade, made a better showing than most retailing establishments. Their sales consistently looked strong and averaged some 10% over 1963 levels.

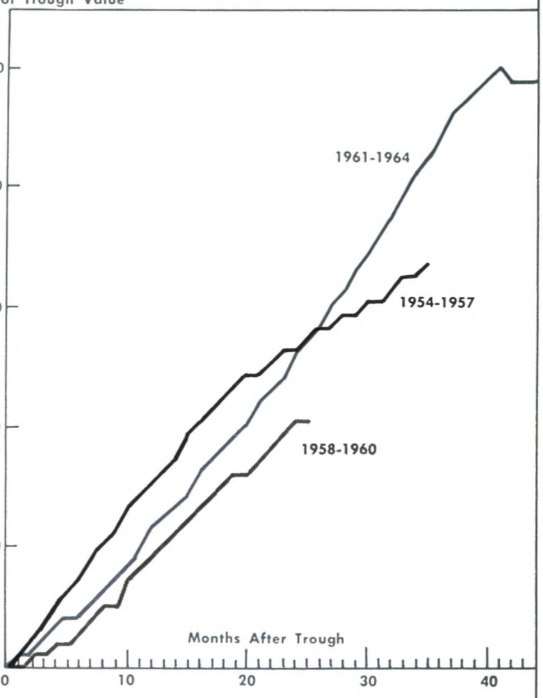
Agriculture District farmers generally had a good year in 1964, but some were beset from time to time with serious problems. Freezing weather in late March and early April damaged fruit crops. Unusual weather continued to harass farmers during much of the year, bringing too much moisture to some and not enough to others. Later in the year and in parts of North Carolina particularly, crops of cotton, peanuts, soybeans, sweet potatoes, and hay, awaiting harvest, were hard hit by heavy rains.

Despite local difficulties, District farmers as a whole fared quite well in 1964. Cash receipts for ten months were up nearly 1% from the previous year in the District compared to a decline of about 1% in the nation. The increase occurred in crop receipts while livestock remained about the same. District gross receipts from flue-cured tobacco sales through December 10 totaled $753 million, up nearly 5% from the prior year largely because of increased volume. Average prices were but slightly higher than in the 1963 season.

The decline in farm workers during 1963 was 9% in the District compared to 6% in the nation. Farm real estate values at midyear were 6.3% higher both in the District and the nation than they were a year earlier. The rise was greatest in Maryland, well above average in South Carolina, slightly below average in North Carolina, and moderately below in Virginia and West Virginia.

Banking Banking in the Fifth District continued to grow at a fast pace in 1964. At the end of October, as the chart on this page indicates, District member banks' loans and discounts had been expanding for 44 months, and stood nearly 50% above the recession low of February 1961. Growth in the current compared with the two prior upswings has proceeded at a faster pace as well as for a longer time.

Total bank credit at Fifth District weekly reporting banks rose more rapidly in 1964 than in other recent years. By December 2, total bank credit had risen more than 8% since the first of the year, compared with a 4% increase for 1963. The expansion in bank credit was due at first to loans and dis-



Trough Months: August 1954, April 1958, February 1961.
*Recent figures partially estimated.

counts, but in November investments rose more than 3% in three weeks. Real estate loans, rising rapidly with construction activity since 1962, increased nearly one fourth in the first 11 months of 1964. The base for this rapid expansion was apparently provided by the influx since 1961 of time deposits, up about one sixth in the first 11 months of 1964 following slightly smaller gains in each of the two previous years. Consumer loans rose about 12% through November, and business loans about 10%.

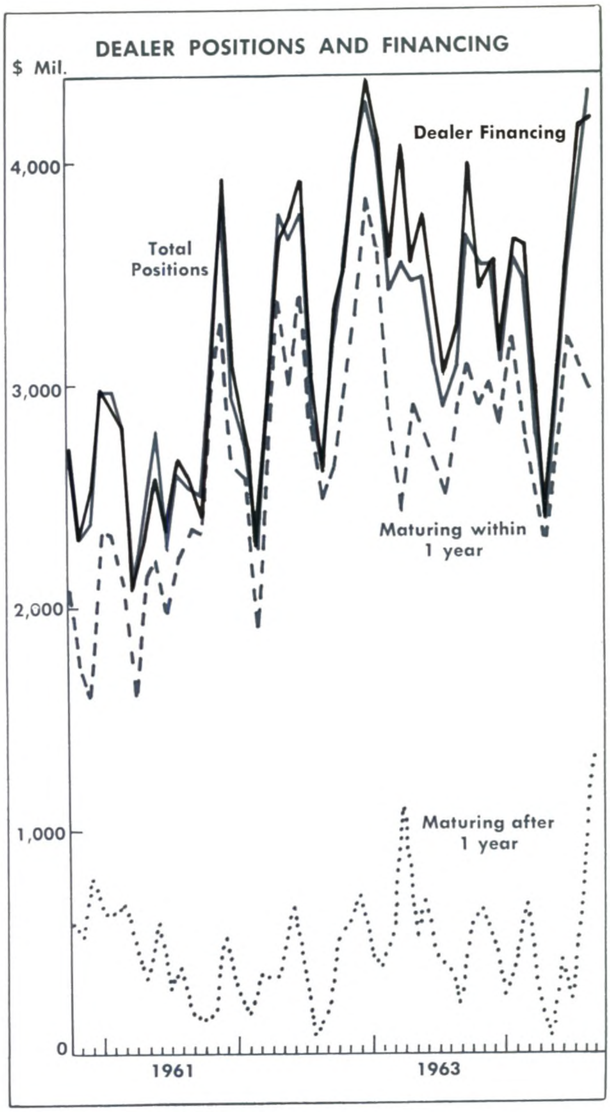
Conclusion Economic growth continued at a fast pace throughout the Fifth District during 1964. Progress was remarkably steady in comparison with previous growth periods. But some of the charts, notably those depicting man-hours, employment, and contract awards, suggest that growth occurred in 1964 with somewhat less consistency than has characterized the present upswing heretofore. Contract awards substantially exceeded 1963 levels, but the uptrend apparently ended around the middle of the year. Most sectors of District business, however, appeared to be moving firmly ahead as 1964 approached its end, promising a strong beginning for 1965. Which patterns will dominate as the New Year matures? The consensus of analysts heard so far anticipates continued growth but at a slower pace.

DEALER LOANS AND REPURCHASE AGREEMENTS

Loans made at very short term to the large Government securities dealer houses constitute an integral part of today's money market mechanism. These loans resemble closely the brokers' call loan, which for many years was the chief money market instrument of interest to banks. Although a sizable fraction of dealer loans are demand obligations, some have specific maturities ranging from one day to several months. The loans with stated maturities are often extended under a contract involving sale of securities to the lender by the borrowing dealer, with a commitment on the part of the latter to repurchase the securities at a specified time at the same price plus a stipulated interest charge. Such contracts are termed repurchase agreements, or simply RP's.

Banks and other money market lenders frequently use dealer loans and repurchase agreements as a convenient means of making short-run adjustments in their liquid assets positions. Thus, these loans compete with other money market instruments that are widely used for the same purposes, i.e., with Treasury bills, Federal funds, negotiable certificates of deposit, bankers' acceptances, prime commercial paper, and discounts and advances at the Federal Reserve. Like these other instruments, dealer loans possess unique characteristics which assure them a special niche in the money market.

Role of Government Securities Dealers The tremendous growth of the Federal debt over the past generation has been accompanied by the development of a highly organized U. S. Government securities market in which a huge volume of business is transacted daily. The smooth and orderly operation of this market requires a vast network of machinery and communications which focuses on a core of about 20 specialized Government securities dealers who operate principally in New York City. A number of brokers, commercial banks, and other intermediaries handle transactions for customers, but most of these institutions turn ultimately to the specialized dealers to execute their orders.



The market for U. S. Government securities is not an organized exchange but rather an over-the-counter market in which dealers buy and sell from their own inventories or positions at their own risk. This feature greatly increases the liquidity of Government securities, since matching buyers and sellers in multimillion-dollar transactions would prove difficult, if not impossible, at least in some maturities.

Importance of the Dealer Function A broad and active market in Government securities is extremely important to the U. S. Treasury, which faces heavy competition from many other borrowers in today's money and capital markets. Such a market imparts to Treasury obligations an extra degree of liquidity which makes them more attractive to prospective lenders.

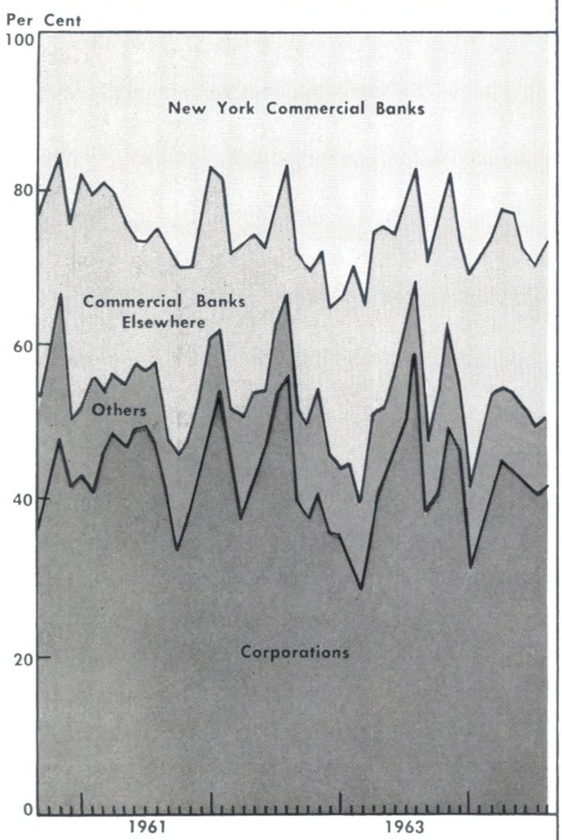
Dealers also play an important role in the Treasury's multi-faceted financing operations. During

Treasury cash and exchange offerings, dealers usually take substantial amounts of the new issues into position, hoping to place them with investors as demand develops. Without dealer participation these periodic deluges of new issues would be extremely difficult for the market to absorb and would tend to depress prices temporarily to unrealistic levels.

In addition, Government securities dealers occupy a strategic position in the machinery through which the monetary authorities influence the availability and cost of money and credit. Through them, the Federal Reserve conducts its open market purchases and sales of Government securities to influence member bank reserves. The effects of Federal Reserve operations thus impinge first on Government securities dealers and spread from them to all financial markets.

Dealer Financing Dealers finance the major portion of their sizable positions or inventories with borrowed money, and consequently total positions and total financing fluctuate closely together, as may be seen in the chart on page 10. Discrepancies between the two series result primarily because data on positions are reported on a commitment basis while data on financing are reported on a delivery basis. The lag between commitment to buy or sell and actual delivery is sufficient to account for significant discrepancies, even when monthly averages of daily figures are used.

SOURCES OF DEALER FINANCING

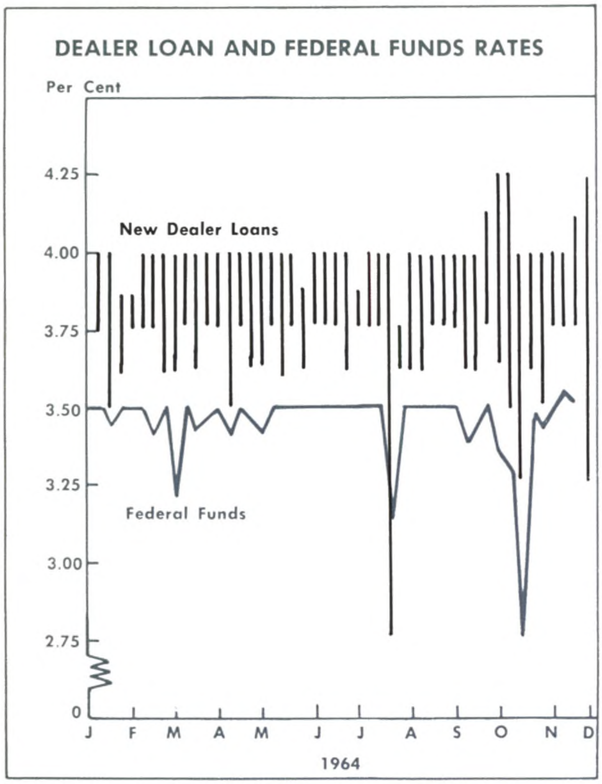


Lenders Dealer financing requirements are ordinarily quite large. Their daily average needs in the first half of 1964, for example, were $3.2 billion. Since borrowing is such an important part of their activities, one of their prime concerns each day is to secure loans to meet their requirements at the lowest costs possible. Competition has forced them to search the country for new sources of funds at low interest rates and to fashion attractive loan arrangements adapted to the needs of each different type lender.

Suppliers of dealer loans include commercial banks, nonfinancial corporations, and miscellaneous lenders such as state and local governments, foreign institutions, insurance companies, and—when necessary to implement monetary policy—the Federal Reserve Bank of New York. Since September 1960 when the Federal Reserve began collecting statistics from all primary dealers, corporations have supplied on the average about 45% of dealer financing, banks in New York City about 25%, banks elsewhere about 21%, and other lenders about 9%. Because rates charged by out-of-town lenders are generally lower than those charged by New York City banks, dealers usually try to tap out-of-town sources early in the morning and turn to the New York banks for their residual needs later in the day.

Many lenders, especially corporations, prefer repurchase agreements to the more conventional type loan. From the corporate standpoint, repurchase agreements afford the advantages of good rates of return and convenient maturities, ranging from one night to several months and easily tailored to coincide with corporate needs for cash. Another attractive feature is the absence of market risk which dealers assume by contracting to repurchase the securities at a specified price.

Commercial banks outside New York City are another important source of funds. In contrast to New York banks, they usually will not lend to dealers when their reserve positions are so low that they may subsequently be forced to borrow in the Federal funds market. They make both collateral loans and repurchase agreements with dealers, and often prefer these alternatives to selling Federal funds because the rate of return is frequently higher. Repurchase agreements, however, may involve considerable trouble and expense because title to the securities must be



transferred, and many banks regard RP's as unprofitable unless they run for three days or more.

New York Bank Lenders If dealers cannot find financing elsewhere, they then turn to the banks in New York. Although rates charged by New York banks are generally higher than those charged by out-of-town lenders, most dealers do part of their daily borrowing at these banks. Their proximity is convenient for late-in-the-day transactions and for cash transactions which require payment and delivery on the same day as the transaction is negotiated.

New York banks regard collateral loans to dealers as one very important means of adjusting reserve balances to desired levels. Their preference will generally hinge on relative costs, the availability of alternative instruments, and the length of time reserve surpluses (or deficiencies) are expected to last. As a rule the rate of return on dealer loans is higher than on other reserve adjustment media.

Each morning the major money market banks in New York post dealer lending rates for both new loans and renewals. Depending on their reserve positions and conditions in the money market, they encourage or discourage dealer loans by varying the rates they charge. Consequently, on a given date the posted rate may vary somewhat from bank to bank. There are five major banks that stand ready to make loans to dealers at their posted rates even if such transactions force them to purchase Federal funds to replace their reserve losses. Thus, at some price dealers are always able to finance their positions.

If the money market is particularly tight and the Federal Reserve needs to supply reserves to the banking system, the Federal Reserve Bank of New York may agree to enter into repurchase contracts with dealers. These agreements are made only at the initiative of the Federal Reserve and are an important complement to regular purchases and sales of Government securities in the open market. They are particularly useful when reserves are currently needed but reserve projections indicate that market factors will add substantially to reserves in the next few days. In such a case the Federal Reserve may make repurchase agreements scheduled to mature when reserves will probably be more readily available. This procedure makes it unnecessary to buy a large block of securities one day and sell them the next or in the very near future. Repurchase agreements have also been used in the Federal Reserve's effort to keep short-term rates up for balance of payments reasons. Their use avoids the direct downward pressure exerted on bill rates when the System buys short-term Government securities outright.

Conclusion Dealer loans and repurchase agreements are important money market instruments. Nonbank participants in the money market frequently adjust their liquidity positions by making RP's with dealers or by allowing maturing RP's to run off; and banks, under certain circumstances, like to adjust reserve positions by use of dealer loans instead of through such alternatives as Federal funds, Government securities, bankers' acceptances, or certificates of deposit.

Since dealer loans are fairly close substitutes for other money market instruments, it is logical to expect a fairly close relationship between rates on dealer loans and other money market rates. Because dealer positions are financed primarily with borrowed money, a rise in dealer loan rates, for example, may induce dealers to lighten inventories by marking down prices, which raises the effective return to investors. Although the relationship between various short-term rates is not fixed or rigid, a rise in one tends to be transmitted fairly soon to several of the others.

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