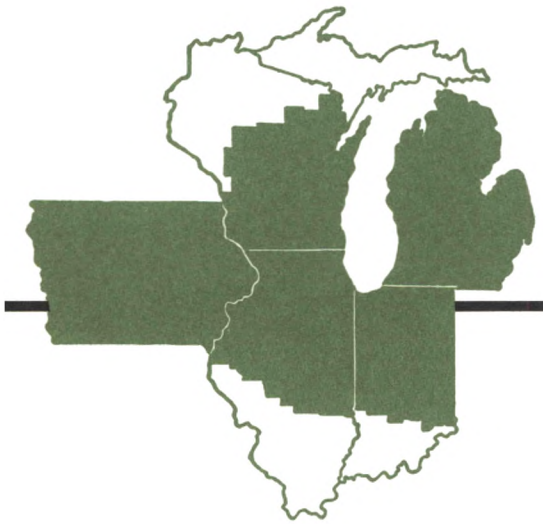
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



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Banks, too, post collateral

Most people think of collateral as something that a bank requires a borrower to furnish as security for a loan. Such collateral may be in the form of a lien upon a physical asset or it may be a financial asset such as a Government or corporate bond, which itself is an evidence of indebtedness. A bank will accept as collateral, of course, only those assets which it judges to be sufficiently sound and liquid to provide protection against loss in case the borrower should be unable to repay his loan at maturity. Acceptable collateral is typically something easily identified, readily marketable and of fairly stable value. A loan applicant possessing such high-grade assets (and who otherwise meets minimum standards of credit worthiness) normally has little trouble getting credit accommodation.

Not so well understood is that banks themselves must often post collateral against certain of their liabilities. Just as individual or business borrowers pledge houses, stock, bonds, inventory, cattle or equipment as security for bank loans, member banks must pledge specific assets as collateral when they find it necessary to obtain temporary accommodation from their Federal Reserve Banks.

There are two methods by which member banks can obtain credit from their Federal Reserve Banks. One is by endorsing and discounting "eligible" paper at the Reserve Bank. This was the method commonly used in the early days of the Federal Reserve System, and it was this process which gave rise to the term "discount window" and "discount rate." The statute provides that short-term negotiable notes and drafts drawn for specified purposes related to the working capital needs of commercial, agricultural or industrial borrowers are eligible for discount. Such paper constituted a large share of bank assets in the early days of the System, and it was contemplated in the Federal Reserve Act that the provision for discounting this self-liquidating paper would automatically result in the proper amount of money to accommodate the needs of business—in short, an elastic currency.

The second method of extending Federal Reserve credit to a member bank is through advances on the member's own note, secured either by eligible paper (as described above) or by U. S. Government securities. Such collateral must be delivered and held in custody accounts at the Reserve Bank; in practice, Government securities are often already held there for safekeeping.

In addition, at a premium of ½ of 1 per cent above the discount rate, member banks can borrow on any other asset judged to be

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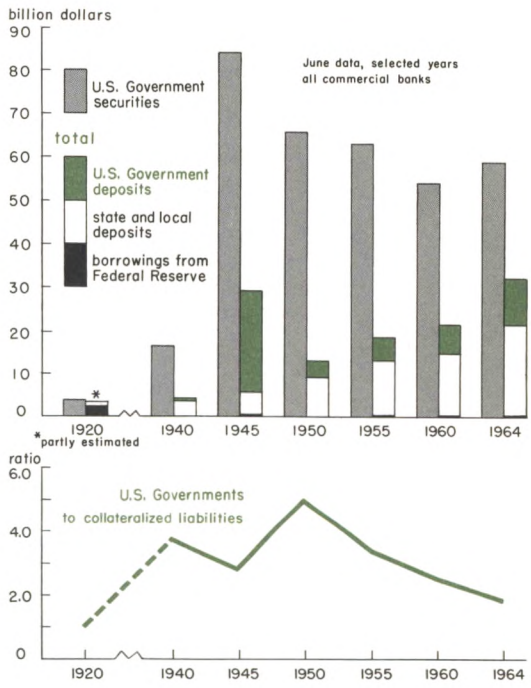
sound by the Reserve Bank even if it does not meet the requirements for eligible paper.[1]

For a good many years member banks have borrowed from Federal Reserve Banks mainly through advances secured by Government securities. This practice reflects the great convenience of such securities for use as collateral because of their unquestioned credit rating, widespread availability and variety of denominations.

Why banks borrow

When a member bank borrows at the discount window, it receives credit in its deposit balance at the Reserve Bank. These deposits serve as clearing balances and the legal reserves member banks are required to hold against their deposits. While the growth and variation in the aggregate volume of bank reserves are governed mainly by Federal Reserve System open market operations, the distribution of these reserves is determined by the forces of the marketplace. Deposits of individual banks fluctuate widely from day to day and week to week as a result of transactions by the public and the Treasury and even by System open market operations, which have their initial impact on the central money market. Individual banks are subject to frequent, substantial and often totally unexpected deposit drains which, although temporary, force them to take action to maintain their reserves at legally required levels.

Banks' U. S. securities have shrunk in relation to collateralized liabilities



A great deal of flexibility in adjusting to these developments is provided by the sale or maturity of liquid assets and, especially for larger banks, the ability to borrow reserves for a day at a time from other banks through the Federal funds market. Nevertheless, it is often appropriate for individual banks to obtain needed funds at the discount window to meet a temporary reserve deficiency.

In many cases the need to borrow results from the bank's efforts to serve unusual credit needs of its customers promptly and adequately. Just as businesses need bank credit to tide them over periods when their re-

[1]A proposed amendment to the Federal Reserve Act (S.2076, H.R.8505, 88th Congress) is designed to change the provisions with respect to collateral for member bank borrowings in recognition of the changes that have occurred in banking practices and the composition of bank assets. This amendment would remove the present eligibility rules and permit banks to borrow at the regular discount rate on any assets satisfactory to the Federal Reserve Banks, subject to such regulations as the Board of Governors of the Federal Reserve System might prescribe.

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sources are out of phase with their outlays, so banks must sometimes borrow when the loan demands of their customers are not perfectly coordinated with the growth in their deposits or with adjustments that could reasonably be expected to be made by disposing of liquid assets. The guiding principles relating to access to the discount facilities are stated in the foreword to Regulation A, which sets forth the rules governing discounts and advances by Federal Reserve Banks, as follows:

> Federal Reserve credit is generally extended on a short-term basis to a member bank in order to enable it to adjust its asset position when necessary because of developments such as a sudden withdrawal of deposits or seasonal requirements for credit beyond those which can reasonably be met by use of the bank's own resources. Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional or local difficulties or from exceptional circumstances involving only particular member banks.

This statement suggests the circumstances under which borrowing by member banks is considered appropriate. Outstanding borrowings at any given time are relatively small—rarely exceeding a billion dollars, or roughly 5 per cent of total member bank reserves—and this is distributed among a constantly changing group of borrowers. But while the aggregates are small, for an individual bank a particular situation may call for a large amount of borrowing in relation to its reserves and, likewise, relatively large amounts of collateral.

Security for "public deposits"

Of much greater importance from the standpoint of the total amount of collateral required are the laws providing that certain assets must be pledged as security against deposits of the U. S. Government—mainly Treasury tax and loan accounts—in excess of the amounts insured by the Federal Deposit Insurance Corporation. Acceptable collateral for deposits of public moneys under the Second Liberty Bond Act, as amended, encompasses a wider range of assets than those acceptable as security for borrowing at the discount rate. Included are U. S. Government securities, state and municipal issues, corporate securities, short-term commercial and industrial paper and other designated obligations with specific provisions as to the valuation of these instruments for collateral purposes.[2] The law further provides that such collateral must be held in custody at the Federal Reserve Bank, or in a depository designated by that Bank.

In addition, the laws of most states and political subdivisions require the pledge of specific assets of generally similar types against their funds with custody usually in the hands of a correspondent bank or another legally designated agent. It might be noted that while state and Federal laws require specific collateral against public moneys, banks are generally prohibited from granting prior claims on any segment of their assets to other classes of depositors.

Governmental units are, for many banks, important deposit customers. At mid-1964 total U. S. Treasury and state and local deposits in commercial banks throughout the nation amounted to almost 32 billion dollars, or more than 10 per cent of all commercial bank deposits. Short-run variations in these totals are wide, due mainly to the uneven

[2]See *Treasury Department Circular No. 92 (Revised)* for detailed description of acceptable collateral and valuation requirements.

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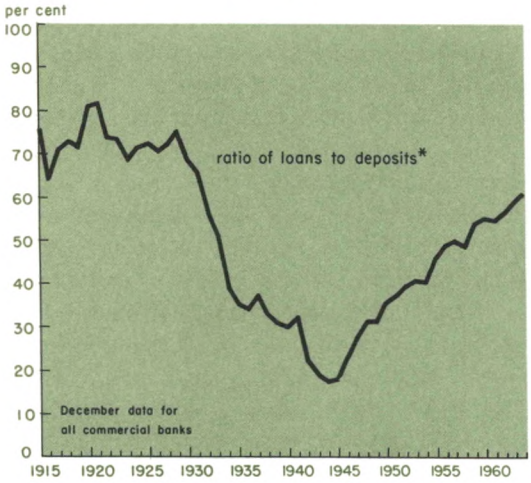
Loan to deposit ratio of commercial banks reaches level of early Thirties



*Loans excluding interbank loans; deposits net of cash items in process of collection.

impact of Federal tax receipts and expenditure patterns. For individual banks, moreover, fluctuations in state and local balances are also large. With the growing volume of state and local deposits combined with the steady uptrend in the ratio of loans to deposits (and the related decline in holdings of Government securities), the margin of Governments over collateral needs has shrunk and individual banks occasionally find themselves faced with a severe "shortage" of Government securities which may be used as collateral for borrowings. Such shortages occur at times when a high level of public deposits happens to coincide with reserve drains due to adverse clearing on private balances or other temporary needs.

Customer paper as collateral

Such occasions have prompted a number of banks to renew their acquaintance with the use of other acceptable collateral in obtaining Reserve Bank credit and in securing their public deposits as well. On the other hand, despite the fact that the discount facilities were set up for this specific purpose, many banks appear to be hesitant either to discount eligible customer paper or to offer it as collateral for Federal Reserve advances, perhaps in part because of uncertain customer reactions. Since, for many years now, the amount of U. S. Government securities held by banks has been more than ample to provide for collateral needs as well as short-run liquidity, bank loan customers have become accustomed to seeing no endorsements on their matured notes.

Endorsement — once fairly common — shows that the notes have been discounted or used as collateral for borrowing by the lender. Bank customers may again see such endorsements on their notes with somewhat greater regularity as banks more closely approach the loan ratios that were more common in the years prior to the depressed period of the Thirties and the acquisition of the huge portfolios of Governments during World War II. This development would simply reflect a continuation of the postwar trend for banks to use their resources less for investment in liquid assets and more for the accommodation of business and industry. Given an appropriate reason for a member bank to borrow, in principle it is of no consequence what type of collateral is used in the implementation of such borrowing. The relative convenience of alternatives is the determining factor.

The banking system as a whole still appears to have ample holdings of Governments to meet its collateral requirements. At the end of 1964 commercial banks held about 60 billion dollars of these securities—nearly twice the total volume of public deposits and

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borrowings from the Federal Reserve combined. Part of this, however, represents securities in trading positions of large banks that have dealer departments. It has been mainly at the large city institutions which have been aggressive in serving their loan customers over the past few years and whose Government deposit and borrowing needs fluctuate widely from day to day that the adequacy of Government security collateral has posed problems. Member banks in New York and Chicago now have only one-third the amount of Governments they held at the end of World War II, while for all other commercial banks Governments are still 75 per cent of the 1945 level.

As indicated earlier, many types of securities, including state and approved municipal obligations, are acceptable at specified valuations as collateral for the deposits of most governmental units, but eligible collateral for borrowing at the discount rate is much more limited. Substitution of other acceptable collateral as security for public deposits would, of course, free Governments not only for use as security against borrowings but also for other purposes—market transactions, liquidity and generally greater flexibility in reserve management. However, a limiting factor in the use of some assets, particularly municipals, is their unit size. Any paper denominated in small units is inconvenient for collateral purposes due to both the physical problems of transport and storage and the necessity to examine each item to determine its acceptability.

For the most part, banks will continue to pledge U. S. Government securities as collateral for both public deposits and borrowings from Federal Reserve Banks. However, some flexibility is required, and it seems likely that the most practical and appropriate alternative would be to resort to the well established precedent but nearly forgotten practice of using prime customer paper to serve banks' collateral needs.

Common Market policy expected to restrict U. S. farm exports

The tariff negotiations which began in Geneva last May are providing a test of the possible impact of the trade liberalizing features of the Trade Expansion Act of 1962. The purpose of this act was to achieve, if possible, further worldwide reduction of man-made barriers to the international exchange of goods, including agricultural products.

The United States, with a large and persistent deficit in its balance of international payments and capacity to produce larger quantities of agricultural commodities is vitally interested in enlarging its foreign shipments of farm products. In the year ended June 1964, United States agricultural exports exceeded 6 billion dollars. This nation is a leading exporter of wheat, feed grains, soybeans, cotton, tobacco, lard and tallow.

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United States exports to EEC—1963

Commodity	Total United States agricultural exports	Exports for dollars	United States exports to EEC	EEC as per cent of total	EEC as per cent of dollar sales
		(million dollars)			
Feed grains	794	720	276	35	38
Wheat and flour	1,330	359	73	5	20
Oilseeds and products	827	719	247	30	34
Animals and products	709	551	152	21	28
Cotton, excluding linters	576	420	132	23	31
Tobacco, unmanufactured	403	367	104	26	28
Fruits, vegetables and nuts	449	447	102	23	23
Others	496	371	85	17	23
TOTAL	**5,584***	**3,954**	**1,171**	**21**	**30**

*Includes exports under Government programs of grants and sales for inconvertible currencies.

But agricultural protectionism is deeply entrenched in the laws and tradition of many countries, including the United States. With governments deeply committed to farm aid programs, negotiators face a difficult task in moving toward freer trade in agricultural commodities on a mutually acceptable basis.

The EEC

One of the more important developments in the sphere of foreign trade in recent years has been the formation of the European Economic Community or Common Market. While fostering freer trade within the area, this group of countries has not moved aggressively toward freer trade with countries outside the area.

The European Economic Community's Common Agricultural Policy (CAP), adopted by its six member countries in January 1962, constitutes a plan for the unification of the six members' agricultural sectors. In essence, it calls for the achievement by the end of the Sixties of a system of unified "target" prices throughout the community for every important agricultural commodity produced in the area—notably grains, livestock, dairy products and poultry. Imports from outside the community are to be subject to a "variable levy" which will be the difference between the target price and "the most favorable buying terms on the external market." In other words, the variable levy is designed to offset the difference between world prices of commodities and desired price objectives in the Common Market. This system could promote a policy of protection and self-sufficiency in the Common Market countries. With high internal prices and protection against imports afforded by the variable levies, EEC farmers would have the incentive to expand uneconomic production. EEC internal price levels, therefore, are the key to the effects of the variable levies on trade with outside countries.

Recent moves by the EEC

Members of the European Economic Community recently agreed on a common price for grains, generally accepting basic price levels previously proposed, and set July 1, 1967, as the date on which these common

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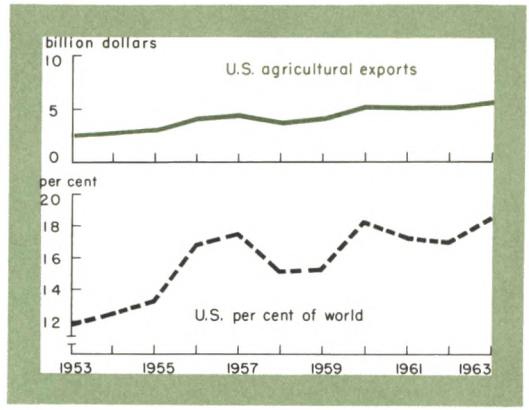
prices are to be applied in all six member countries. Adoption of the common grain prices makes possible the future establishment of common prices for many other farm products as pork, poultry, eggs, dairy products, beef and veal.

While the adoption of the common grain prices should facilitate current trade negotiations, the agreed upon price levels indicate that imports by Common Market countries will be subjected to more restrictive levies if production in those countries is substantially stimulated. The target price for soft wheat was set at $106.25 per metric ton or about $2.89 per bushel—a compromise between the community's highest price of $118.90 per ton in Germany and its lowest price in France of $100.20. This is more than $1 per bushel above the United States landed price in West Germany.

Price levels for other grains were also set considerably higher than the equivalent United States delivered prices. The target price for rye was placed at about $2.38 per bushel compared with about $1.50 for American rye. In response to a request by Italy, which imports a large part of its feed grain supply, prices for barley and corn, $1.98 and $2.30, respectively, were set lower than originally proposed but are still well above the United States delivered level. Furthermore, the community adopted a system of subsidies and levies, with compensatory payments to be made to German, Italian and Luxembourg farmers to offset farm income declines due to the new target prices.

Under the arrangements, no amount of price reduction, whether it reflects export subsidization by foreign governments or normal developments in the world market, is likely to assist foreign producers to penetrate the EEC market. France is the community's largest grain producer and exporter. Many

United States share of world trade has grown



observers feel that the established grain price levels, that are well above the present French levels, will stimulate production in France and in other low cost producing areas in the Common Market countries.

During the five-year period from 1956 through 1960, domestic production in the Common Market countries relative to total domestic utilization averaged 89 per cent for wheat and 75 per cent for feed grains. Although weather conditions have held production down in recent years, further strides by EEC countries toward self-sufficiency will probably be made.

Wheat imports to the EEC, while expected to decline, may continue larger than might be indicated by the output relative to utilization in these countries. This would reflect the demand for high-protein wheat (which cannot be produced in significant quantities in EEC countries) for blending with low-protein locally produced wheat. Also, with rising employment and incomes in the European countries bringing increased consumption of livestock products, annual feed grain consump-

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tion is expected to rise, possibly slowing the expected decline in imported feed grain requirements.

Nevertheless, it is expected that many foreign products sold in competition with domestic output will be displaced from Western European markets. At the least, the EEC's system of variable import levies against foreign products will tend to stimulate high-cost domestic production, thus potentially displacing imports from traditional outside suppliers in both developed and developing countries.

As the Common Market's largest traditional supplier, the United States is especially interested in Western Europe's policies affecting agricultural imports. In 1963 countries in the EEC imported about 1.2 billion dollars in agricultural products from the United States—about one-fifth of all United States farm exports. Furthermore, EEC countries are by far the leading importers of American agricultural products paid for in dollars or convertible currencies.

EEC important United States customer

Country	Total United States exports	
	1953	1963
	(per cent)	
Common Market (EEC)[1]	23	21
Japan	13	12
Canada	9	11
United Kingdom	10	7
India	2	6
Pakistan	3	3
UAR-Egypt[1]	1	3
Other	39	37

[1]Includes countries comprising respective areas.

In other countries as well

Common Market countries, however, are not alone in fostering policies that result in high-cost agriculture production internally and the restriction of competition from foreign producers.

In nearly all countries the market for agricultural products is influenced extensively by government programs or those of government-sponsored producers' associations. Output is conditioned or directed by financial inducements and penalties, and marketing processes are "controlled"—usually for the purpose of boosting prices and income of the agriculture sector.

The typical pattern of government support of domestic agriculture comprises tariffs, quantitative import restrictions (including sanitation and disease controls), government-guaranteed minimum prices, subsidies (including subsidized credit), financial assistance on favorable terms for making specified farm improvements and control of marketing. A key element in such programs is the import quota, which can be used to deny access of imports unless it is evident that the domestically produced supply of a commodity will sell at the established price.

In some countries (for example, Switzerland and Norway), price support is provided for virtually every important agricultural product. By contrast, in the United Kingdom the prices of most agricultural commodities are allowed to fluctuate, but the producers are guaranteed a specified price, and if the average market price (greatly influenced by imports) is below this level, farmers receive a "deficiency payment."

Achieving some specified level of prices is more difficult for countries (like the United States) with surplus output than for those (like Germany) whose production is not suf-

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ficient to meet the domestic demand at "normal" prices. The former, by one means or another, often establish two prices for the same product, a higher price for domestic sales and a lower one for foreign sales.

Such conditions are often a source of international friction. For example, sales of wheat by the United States abroad at prices below those in the domestic market may appear to non-American producers as "unfair competition." Anti-dumping laws provide for the protection of United States producers from similar actions by other countries.

Price supports, direct or indirect, are not the only subsidies to agriculture. Other aids often extended are designed to raise farm output per worker, per unit of land area, or both, in the expectation that increased output per farm will make farming more profitable or less dependent on price-support actions. The benefits of such programs often flow largely to consumers since total output tends to rise and to depress prices, in turn complicating the efforts to support prices and boost sales abroad.

In addition to subsidies for research and experimentation in agriculture and dissemination of the results to the agricultural population, governments often make large investments in programs for land improvement and control of pests and diseases affecting plants and livestock. For example, in the Netherlands, where these expenditures are highest in relation to both population and area of cultivated land, investment in reclamation is done largely at public expense.

Conclusion

Few governments leave the direction of their agriculture entirely or even largely to the market forces, in part because of the ever-present danger of war with its potential disruption of foreign supply lines. In addition, in nearly all countries, agricultural interests have strong political leverage, and—at least in the Western world—a view that a rural way of life is favorable in contrast to the rapidly growing urban populations with their widely publicized restlessness, tension and crime. It is likely, therefore, that agriculture will continue to be regarded as a favored sector of each economy and to be deeply enmeshed in various governmental programs designed to support the domestic industry.

The success of the Trade Expansion Act and other efforts to move into the sphere of unencumbered world trade will depend largely upon the ability of governments to rationalize the interests of domestic agriculture with the availability of supplies from outside sources and the alternative uses of domestic labor and capital. The immediate prospects for a substantial reduction in trade restrictions and the achievement of freer international trade in these commodities must be viewed at best with limited optimism.

Annual Report

The *1964 Annual Report* of the Federal Reserve Bank of Chicago contains the Bank's financial statements, brief reviews of last year's developments in business, agriculture and banking, and an illustrated feature article "Steel Begins Its Second Century." The study discusses historical trends and future prospects of the steel industry from the standpoint of technology, location, markets and finance. Copies of the *Annual Report* may be obtained by writing to the Bank.

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Crosscurrents in savings deposit flows—some recent evidence

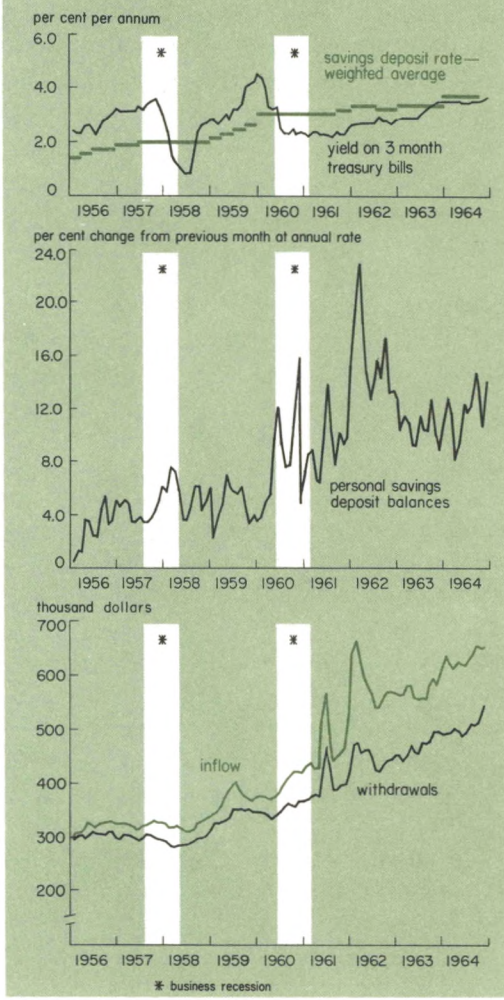
Changes in commercial bank savings deposits are, of course, the net result of amounts added to and withdrawn from accounts. Since inflows may respond differently than withdrawals to changes in income, interest rates and other factors, it sometimes is helpful in evaluating savings trends to analyze these measures separately as well as in terms of their combined effect on balances.

Statistics on savings deposit inflow and withdrawals are available for banks located in urban areas of the Seventh Federal Reserve District.[1] As the accompanying chart indicates, amounts added to savings accounts at these banks generally have increased, as have amounts withdrawn. These gains in gross flows, like those in balances, mainly reflect growth in population and personal incomes.

Savings deposits at the District banks have increased at a faster rate during recent business recessions than during the immediately preceding years of rising economic activity. In the recession year of 1958, for example, savings deposits at District banks rose 5 per cent, compared with a 4 per cent increase during 1957 and 3 per cent in 1956. Growth in savings deposits remained at 5 per cent during 1959 but rose—to 7 per cent—during the recession year of 1960.

The gains in the growth rate of savings

Interest rate changes affect growth of savings deposit balances at District banks



[1]Savings deposits refer to individuals' combined holdings of "passbook" savings accounts and time certificates of deposit. Except as otherwise indicated, data refer to commercial banks in 51 metropolitan and smaller urban centers in the Seventh District.

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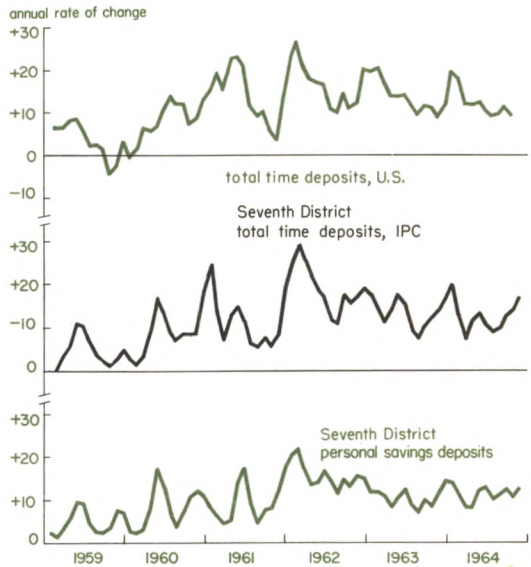
balances during the recession years were mostly the result of slower growth or outright decreases in deposit withdrawals. Indeed, inflow actually declined during 1958. It rose during 1960 but at a slower pace than in 1959.

Accelerated growth of savings deposits during recession years, therefore, is explained largely in terms of forces affecting withdrawals rather than forces affecting inflows of savings. Individuals may be reluctant to draw down their balances for the purpose of supporting current spending during business recession. Also, the relative improvement in the yield on savings deposits—since rates paid to savings depositors tend to remain unchanged while market rates of interest decline—may reduce the incentive to move funds from savings deposits into other assets and thereby reduce withdrawals.

Savings deposit flows during periods of business expansion have been greatly affected at times by deposit interest rate increases; indeed, increases in payments to savings depositors characteristically occur during periods of business expansion. In the Seventh District, rate increases were especially widespread during the 1956 third quarter, 1957 first quarter, 1959 third quarter and 1962 first quarter. The proportion of District banks posting higher rates was comparatively large also in the first quarters of 1960 and 1964, reflecting increases at Indiana banks immediately following revision in the state regulation governing maximum rates. The effect of higher interest rates on savings deposits is both to boost inflow and to reduce withdrawals.

The growth of savings deposits at the District's banks accelerated during 1961 and has remained at a higher rate during the current upswing in activity than in earlier periods of business expansion. This strong rise in savings deposit balances is largely attributable to the rise of inflow. Growth in balances picked up during both 1961 and 1962 as the expansion of inflow more than offset the growth in withdrawals. Savings inflow re-

Total time deposits and personal savings component compared



Note: The increased ownership of time deposits by corporations since 1961 has made the series for savings deposits and total time deposits of individuals and businesses more divergent in recent years than earlier.

The Seventh District series on savings deposits can be taken as a proxy for national data, at least in a broad sense, without substantial error. Comparisons of savings deposits at District banks with total time deposits at all commercial banks in the United States, excluding interbank, U. S. Treasurer's open account and postal savings deposits, reveals a rise each quarter in both series, except in the first quarter of 1960 when time balances at all commercial banks in the United States declined. The rate of increase in both series was higher at the cyclical trough of the first quarter of 1958 than during any of the 1956 and 1957 quarters. A sharp upturn in growth occurred in both series around mid-1960. Rates of growth remained relatively high during the 1960-1961 recession. Also the first quarter 1962 peak was identical in both series.

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mains at a relatively high level, in contrast with its performance after the first stages of the last two preceding business expansions of 1954-57 and 1958-60. Furthermore, with some additional increases in interest rates on savings deposits effective the beginning of the year and prospects that personal income will continue to rise, there is no indication that a slowing of the current rise in savings balances is imminent.

World sources and uses of gold

Uncertainties in international financial conditions in the closing months of 1964, stemming primarily from the pound sterling crisis, probably prevented Western central banks from achieving a record increase in their gold holdings during the year. Official gold holdings of international institutions and Western central banks rose 705 million dollars in the first nine months of 1964 compared with 430 million in the same period in 1963 and only 325 million in all of 1962.

Purchases by official institutions account for only a portion of total purchases of new gold each year. The remainder is purchased either for use in industry and the arts or by private sources as a store of value and hedge against devaluation of national currencies. The distribution of gold among these purchasers is dependent, in large measure, upon changes in confidence in political and economic conditions both at home and abroad.

Changes in official gold holdings tend to move inversely with changes in private holdings. When international tensions are low, official gold holdings expand faster than private holdings. When confidence is disturbed by either the threat of war or serious deterioration in a major country's balance of payments, fear arises about the future value of national currencies and private sources tend to acquire the bulk of the new gold offered for sale. (Although private citizens and business firms in the United States and United Kingdom may not own or purchase gold other than for industrial, artistic and limited numismatic uses, residents of many other countries may do so.)

The relation between changes in international political and financial conditions and changes in official and unofficial holdings of gold may be seen from the table. At the end of 1956, the concurrent Hungarian Revolt and Suez crisis gave rise to fears of wider international conflict. As a consequence, private demand for gold to hoard rose sharply at the expense of gains to official holdings.[1]

In 1960, concern over the size and duration of the balance of payments deficit, which had existed every year since 1950, with the single exception of 1957, suddenly became widespread. Fears of a possible devaluation of the dollar and other currencies were dra-

[1]Changes in private gold holdings are estimated to be the residual change after increases in official holdings and consumption by industry and the arts are substracted from total new gold supplied. Newly minted gold coins are included with private holdings as these coins are typically not designed to, and do not, circulate as media of exchange. Most new coins are minted by a few countries to sell to private holders at premium prices.

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matically reflected in a sharp jump in the price of gold on the free gold markets of the world. The gold price on the important London market rose abruptly from a few cents above $35 per ounce—the usual selling price—to about $40 per ounce. Although the price quickly declined again to near $35, demand from private sources remained high and the amount of gold estimated to have moved into private hoards during the year rose over 700 million dollars. This was 60 per cent above the 1959 level and more than twice the estimated additions to private holdings in 1958.

Despite the Berlin crisis near the middle of the year, firm notice of the United States intentions to reduce its international payments deficit and maintain the official price of gold at $35 an ounce dampened private demands for gold in 1961. Private takings declined nearly 20 per cent, while official gold holdings rose 75 per cent more than in 1960.

During 1962 the abrupt decline in stock prices early in the year, the Cuban missile crisis later in the year and recurring doubts of the United States ability and/or willingness to take stronger actions to reduce its balance of payments deficit combined to give a strong push to private demands for gold. Additions to private holdings jumped more than one-third, while central banks and international institutions increased their holdings only half as much as in 1961.

Reasonable world tranquility and a marked improvement in the United States balance of payments in the second half of 1963, following the introduction of such stronger measures as an increase in the Federal Reserve Banks' discount rate and presidential recommendation of the interest equalization tax, contributed to a slight decline in the rate of expansion in private gold hoarding and a sharp increase in additions to official holdings of gold. The estimated smaller addition to holdings of private purchasers occurred even in the face of the record increase in gold supplied from new production and Russian sales. The latter were substantially greater than in any other postwar year and almost twice the amount in the previous peak years, 1959 and 1961. The jump in sales could be attributed in large part to the USSR's need to

Record increase in official gold holdings in 1963

	Sources[1]		Uses[1]			
			Change in official holdings[2]		Consumption by industry and the arts	
	Production	Sales by USSR	World	United States		Residual
	(million dollars)					
1955	940	75	+680	− 40	177	158
1956	975	150	+485	+ 305	186	454
1957	1,015	260	+705	+ 799	222	348
1958	1,050	220	+680	−2,275	283	307
1959	1,125	300	+750	−1,076	224	451
1960	1,175	200	+345	−1,703	316	714
1961	1,215	300	+600	− 857	311	604
1962	1,290	200	+325	− 890	327	838
1963[a]	1,350	550	+850	− 461	325[b]	725[b]

[1]Gold valued at $35 per fine troy ounce. World estimates exclude USSR, Other Eastern European Countries, China Mainland and North Korea.
[2]Holdings of central banks and international institutions.
[a]Preliminary. [b]Projected.

SOURCE: *Annual Report of the Director of the Mint, Annual Report of the Bank for International Settlements* and *IMF, International Financial Statistics.*

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acquire United States dollars to help finance heavy purchases of Canadian and American grain during the year.

The gold pool

In recent years, the central banks of eight Western countries including the United States have combined forces to stabilize the price of gold on the London market. The so-called "gold pool" sells gold as the price rises and buys gold as the price declines. As a result, since 1962 the price of gold has fluctuated within a narrow range of $35.05 and $35.19 an ounce compared with a considerably wider range in earlier years.

Pool purchases and sales are apportioned among the participating countries according to an agreed upon formula.

United States acquisitions from the pool are included in the figures on gold purchases from the United Kingdom. In 1963, almost all of the gold purchased from Britain represented distributions by the pool. It may be estimated that the greater share of the purchases in the first nine months of 1964 also represented such gains. The remainder was sold by the United Kingdom to help finance the large deficit in its balance of payments.

Because of the spurt in foreign private speculative demands for gold near the end of 1964, the United States gold stock declined slightly for the year as a whole. At the end of 1964, the gold stock totaled 15,471 million dollars, down 125 million from year-end 1963. Although 1964 was the seventh consecutive year in which the gold stock declined, the decrease was by far the smallest, measuring only about one-quarter as large as the decline in 1963—the previous year of smallest loss. In two months—July and August—the gold stock exceeded the levels of both year-end 1963 and the same months a year earlier for the first time since 1957.

U.S. gold transactions with foreign countries

Country	Purchases (+) and sales (−) 1962	1963	1964*
	(million dollars)		
United Kingdom	−387	+329	+493
France	−456	−518	−304
Germany			−225
Italy			+200
Spain	−146	−130	− 2
Switzerland	+102		− 30
Latin America	+175	+ 32	+ 33
All others	−121	−105	− 56
Total	−833	−392	+109

*First nine months of year.

Gold reserve requirements

The decline of the official United States gold stock and the steady rise in the amount required as reserve against deposits of Federal Reserve Banks and Federal Reserve notes in circulation has sharply reduced the amount of gold not required as legal reserves. About 13.5 billion dollars of the 15.5 billion dollar United States gold stock is currently required as legal reserves. The reserve requirement is primarily a legacy of the days when the United States and most major foreign countries were on a domestic gold standard in which currency and deposits could both be converted into gold at the holder's request. In today's "managed" money economy, the requirement has had no effective influence over the amount of money.

Presidents Eisenhower, Kennedy and Johnson along with Chairman Martin of the Board of Governors of the Federal Reserve

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System have all stated unequivocally that the entire United States gold stock is available to support the international value of the dollar and to meet foreign obligations. Recently, President Johnson has requested Congress to eliminate the requirement against Federal Reserve deposits while maintaining it against currency. In 1945, the last time the stock of gold threatened to drop below the amount required for reserves, Congress reduced the requirement to its present level of 25 per cent.

South Africa—a major producer

Most of the new gold produced by the Western world is mined in South Africa. In 1963, 71 per cent of total production was from that country. Canada accounted for 10 per cent and the United States for 4 per cent.

If all newly mined gold and Russian sales had been channeled into official holdings, such holdings would have increased somewhat more than 3 per cent annually. Since 1954, however, less than half of the new supply has been added to official holdings. Almost as much has been acquired by private holders, while 20 per cent was consumed by industry and the arts. Official holdings have risen only 1.5 per cent annually.

United States still largest holder

Although the United States has experienced substantial gold losses since 1950, it remains the single largest holder of gold. At the end of 1949 this country's official gold stock was at a peak of 24.6 billion dollars, an amount equal to 70 per cent of the estimated total holdings in the Western world. By the end of 1963, the gold stock had declined more than a third to 15.6 billion dollars and its share of the world's stock dropped nearly half to 37 per cent. However, this amount still was almost equal to the combined official gold holdings of the next five largest holders and four times as great as the amount held by West Germany, the second largest holder.

Official gold holdings of major countries

	December 31, 1953		December 31, 1963	
	Billion dollars	Per cent of total	Billion dollars	Per cent of total
United States	22.1	61	15.6	37
West Germany	0.3	1	3.8	9
France	0.6	2	3.2	8
Switzerland	1.5	4	2.8	7
United Kingdom	2.3	6	2.5	6
Italy	0.3	1	2.3	5
World total*	36.3	100	42.3	100

*Includes international organizations but excludes Sino-Soviet Bloc countries.

Gold has played an important role in the economic history of the world. While very largely supplanted by national currencies domestically, and to a considerable extent internationally, gold still holds a significant role in the international economy. Recent events indicate that changes in the private demand for gold continue to reflect, at least in part, changes in world tensions and confidence in national currencies. Apparently many individuals, and official institutions as well, feel more secure holding the non-interest bearing yellow metal than any other kind of asset, gilt edged though it may be. This situation can be expected to change only as the various countries demonstrate further ability to maintain stable domestic prices and international convertibility of their "unit of exchange."

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