Twenty-fourth Annual Report

Federal Reserve Bank of New York

For the Year Ended December 31, 1938

Second Federal Reserve District

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FEDERAL RESERVE BANK
OF NEW YORK

March 8, 1939.

To the Stockholders of the
Federal Reserve Bank of New York:

I am pleased to transmit herewith the twenty-fourth annual report of the Federal Reserve Bank of New York reviewing the year 1938.

GEORGE L. HARRISON,
President.

Twenty-fourth Annual Report

Federal Reserve Bank of New York

The year 1938 witnessed a rapid and unprecedented accumulation of idle funds in the New York money market and a further downward trend in money rates. Economic and political conditions throughout the world combined to create a reservoir of funds here which not only surpassed previous records, but which far exceeded immediate requirements, and which greatly increased the magnitude of the problems of future credit policy. The abrupt decline in business activity in the United States, which started in the autumn of 1937 and continued during the first five months of 1938, helped to provoke conditions and policies which contributed to the huge increase in excess reserves of member banks in this country.

Supply of Funds

The principal factors that produced the record volume of excess reserves near the end of 1938 may be summarized briefly as follows:

1. Abandonment of the policy of gold sterilization by the Treasury, resulting in a release of all of the gold in the Treasury inactive gold account and gradual disbursement of the proceeds;

2. The reduction by the Board of Governors of the Federal Reserve System of the percentages of reserves which member banks are required to maintain against their deposits;

3. The heavy inflow of gold from abroad, especially in the latter half of the year.

With respect to the first factor, the initial step was indicated by the following announcement issued by the Secretary of the Treasury on February 14, 1938:

> On December 22, 1936, the Secretary of the Treasury stated that, after conferring with the Board of Governors of the Federal Reserve System, he proposed to take appropriate action with respect to net additional acquisitions or releases of gold by the Treasury Department whenever it was deemed advisable and in the public interest to do so.
>
> In pursuance of that policy, the Secretary of the Treasury, after conferring with the Board of Governors of the Federal Reserve System, today announces that gold acquired by the mints and assay offices after January 1, 1938, will be included in the inactive gold account only to the extent that such acquisitions in any one quarter exceed $100,000,000. No change is being made in the procedure whereby any gold released by the mints and assay offices is taken from the inactive gold account.

In effect, this announcement reflected a partial abandonment of the gold sterilization policy. It indicated that gold acquired by the Treasury from foreign sources and domestic production would be added to the Treasury inactive gold account only to the extent that such acquisitions exceeded $100,000,000 in any quarter of the year. All gold received not in excess of $100,000,000 in any quarter would be used by the Treasury, and to that extent would tend to increase member bank reserve balances.

Later, on April 14, in a message to Congress, the President announced that all of the gold in the Treasury inactive account, which then amounted to approximately $1,200,000,000, as well as $200,000,000 of other free gold in the Treasury, would be released, and that the proceeds would be disbursed and thus provide the basis for expansion of bank credit. All of this gold was released immediately following this announcement, the proceeds were credited to the gold certificate fund of the Federal Reserve Banks, and Treasury deposits in the Reserve Banks were increased accordingly. While member bank reserves were not immediately expanded by the full amount of the gold released, nevertheless a rapid distribution of funds from the large Treasury balances followed in subsequent weeks, partly through Government expenditures in excess of current receipts, and partly through the retirement of some of the outstanding Treasury bills as they matured.

The second principal factor in the increase of excess reserves occurred on April 15, when the Board of Governors of the Federal Reserve System announced the following reductions in the percentages of reserves which member banks would be required to maintain against their deposits, effective at the opening of business on April 16.

Classes of member banks and of deposits	Prior to April 16	Beginning April 16
Demand deposits:	Per cent	Per cent
Central Reserve City banks	26	22¾
Reserve City banks	20	17½
"Country" banks	14	12
Time deposits:		
All classes of member banks	6	5

This change had the effect of reducing total reserve requirements of all member banks by approximately $760,000,000, and of immediately increasing excess reserves of member banks by a corresponding amount.

The third major factor tending to expand member bank reserves was a net inflow of a substantial amount of foreign capital which, together with heavy payments to the United States on merchandise account, caused a further great increase in the gold stock of this country, especially in the latter half of the year. During the early part of 1938, as the diagram on page 27 indicates, there was a substantial further reduction in the amount of foreign capital held in this country, continuing the movement that started in the latter part of 1937. This outward movement was stimulated by a renewed outbreak of rumors abroad of an impending further devaluation of the dollar. At the same time, however, as in the autumn of 1937, merchandise exports from the United States proceeded at a rate of about $100,000,000 a month in excess of merchandise imports. This excess of exports occurred in spite of a decrease in exports, and was due to a more rapid decline in imports from abroad, accompanying the drastic decline of business activity in this country. On the whole payments due to this country on merchandise account during the first half of the year were in excess of withdrawals of foreign capital from our markets. As a result during that period there were gold imports in moderate amount, which, together with gold acquired by the Treasury from domestic sources, increased the gold stock of this country by approximately $200,000,000.

In the latter half of the year merchandise exports continued largely in excess of imports, but in addition the withdrawal of foreign capital was checked, and in turn a heavy flight of capital from Europe to the United States began. The movement started with the development of tension between Germany and Czecho-Slovakia over the Sudeten issue, and increased rapidly when that situation led, in September, to fears of a general European war. Some moderation of the inflow of capital followed immediately upon the Munich agreement, but continued unsettlement in the European political situation, and the accompanying weakness in sterling exchange, resulted in a further flow to the United States during the last quarter of the year. Total gold imports during the latter half of 1938, exclusive of net earmarkings for foreign account, were nearly $1,500,000,000, and, for the year as a whole, the total increase in this country's gold stock was approximately $1,750,000,000, or nearly one-half of a billion dollars more than the estimated world production of gold during the year.

Altogether the release of unutilized gold by the Treasury, the reduction in the percentages of reserves which member banks are required to maintain against their deposits, and the increase in the gold stock (together with issues of silver certificates and coin against silver acquired by the Treasury), would have increased member bank excess reserves by about $4,000,000,000, had not about one-half of this amount been absorbed by other factors, as is indicated in accompanying table.

	(Millions of dollars)
Factors tending to increase excess reserves:	
Increase in gold stock	1,750
Release of gold from the inactive gold account and other Treasury free gold in April	1,390
Reduction in reserve requirements by Board of Governors effective April 16	760
Increase in Treasury currency (chiefly silver certificates)	160
Total	4,060
Factors tending to reduce excess reserves:	
Net increase in Treasury deposits in Federal Reserve Banks	780
Free gold acquired by the Treasury and not used in 1938	485
Increase in currency circulation	300
Increase in reserve requirements due to deposit expansion	465
Increase in foreign deposits in Federal Reserve Banks	25
Decrease in Federal Reserve Bank credit*	10
Total	2,065
Net increase in excess reserves	1,995

* Due chiefly to repayments of Federal Reserve Bank loans to member banks and to industrial borrowers.

Excess reserves of member banks rose to a new high figure of $3,480,000,000 near the end of the year. The actual increase, however, was slightly under $2,000,000,000, or less than half the potential increase. This difference was due to a number of factors:

(a) The Treasury followed the policy of borrowing funds to meet the expected budgetary deficit, in advance of actual needs. These borrowings had the effect of producing a net increase in Treasury deposits in Federal Reserve Banks of nearly $800,000,000 during the year;

(b) Nearly $500,000,000 of gold acquired during the year remained in the Treasury at the end of the year as free gold, pending the time when the Treasury would find it advisable to use the proceeds;

(c) There was a net increase of approximately $300,000,000 in the amount of currency in circulation, due in part to an increase in the holdings of vault cash by certain member banks, and to some hoarding of United States currency by foreigners during and following the war scare in the autumn, but more largely to a continuation of the partially unexplained upward trend in currency circulation which has prevailed for several years;

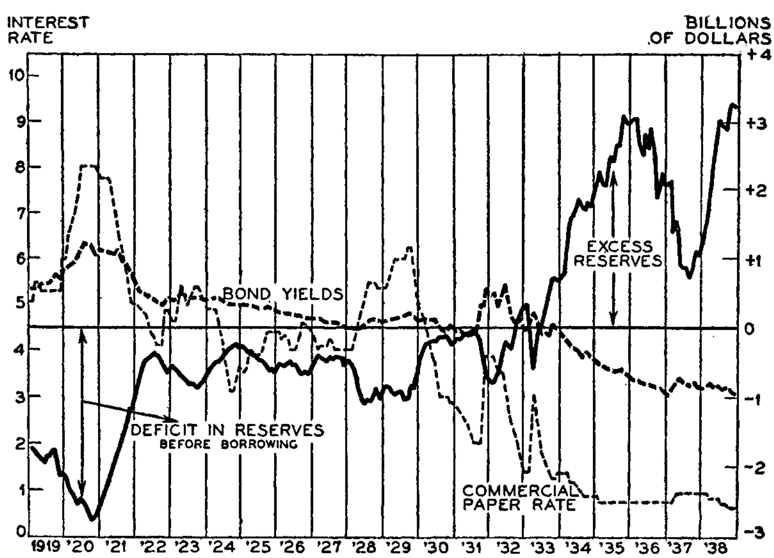
(d) Bank deposits rose to new high levels and there was a consequent increase of $465,000,000 in the amount of reserves which the banks were required to maintain against their deposits.

The influence of some of these factors, which limited the expansion in excess reserves during 1938, was temporary, however, and at the end of the year it was expected that before many weeks the excess reserves of member banks would rise to new high levels. A seasonal reduction of substantial amount in currency circulation and a consequent increase in member bank reserves were in prospect. Furthermore, the Treasury at that time had free gold and balances in Federal Reserve Banks, amounting to more than $1,300,000,000, in excess of minimum working balances. To the extent that these balances are disbursed, member bank reserves will be increased.

Accompanying the rapid and substantial increase in the reserves of member banks during 1938, there was a further decline in short term money rates in the New York money market to lower levels than ever before. Near the end of December, an issue of $100,000,000 of Treasury bills was sold at a price that offered no yield to the purchasers; in fact, the

Treasury was paid a small premium on the issue. Open market commercial paper rates also declined to new low levels in the latter part of 1938, yields on Treasury notes and on the highest grade industrial and public utility bonds reached lower levels than ever before, and yields on long term Treasury bonds declined to levels about as low as had been reached in many years.

This decline in money rates is in accord with past experience, which has indicated that ordinarily there is an inverse relationship between the reserve position of member banks and the level of interest rates. In general, as the accompanying diagram illustrates, the larger member bank reserves become relative to reserve requirements, the lower money rates go, and vice versa. It is interesting to observe, however, that after excess reserves reach large proportions, further additions appear to have a diminishing effect upon money rates, and that when the reserves of member banks rise far above their requirements, even wide fluctuations in the amount of excess reserves can occur with little apparent effect upon the rate structure. In this respect the situation near the end of 1938 was similar to that of 1936 when, in spite of a net reduction of more than $1,000,000,000 in member bank excess reserves, a gradual decline in money rates continued.



Reserve Position of Member Banks Compared with Bond Yields and Short Term Interest Rate

(Data are monthly averages of daily figures. Bond yield line represents Moody's Investors Service data for Aaa corporation bonds)

Supply of Capital for Business

In view of the huge accumulation of idle funds there was an insistent demand for the highest grade investments, corporate as well as governmental, but the flow of funds into new investments of a character involving any appreciable degree of risk, such as the lower grade corporation bonds and stocks, remained limited. There are many factors that have affected this situation, including economic and other difficulties of many industries which had been large users of capital, particularly railroads and public utilities, changes in the investment practices of financial institutions, and changes in the forms and employment of savings. In fact the whole situation with respect to the accumulation and investment of capital has undergone a fundamental change as compared with conditions that prevailed in the 1920's. As in earlier years, however, there have been considerable capital outlays in the manufacturing industries, financed by the use of depreciation allowances and other undistributed earnings.

Commercial bank investments. Between 1921 and 1928, commercial banks in the aggregate were investing in corporation securities at an average rate of about $700,000,000 a year. The total value of such investments in commercial banks, however, was reduced approximately 65 per cent between 1928 and 1934. Except for a moderate increase in the year ended June 30, 1936, there has been no expansion in such investments in recent years. On June 30, 1938, the volume of corporate securities held by all commercial banks was much less than half the amount held ten years before. By far the largest part of the new investments of commercial banks in recent years has been in the form of United States Government securities, although there have also been smaller increases in investments in the securities of States and municipalities and of corporations organized under the sponsorship of the Federal Government. In the last ten years, the total amount of United States Government securities, both direct and guaranteed, held by all commercial banks has increased from about 4 billion to 14 billion.

This change in the investment practices of commercial banks may be attributed in part to the unfortunate experiences of many banks with their lower grade corporation security investments in the years following 1929. Substantial losses were sustained by the banks from 1931 to 1934 as a result of defaults on such securities or heavy depreciation in their market values.

In view of this experience, banks, as a rule, have endeavored to confine their investments to high grade securities, in line with practices encouraged by bank examiners. As a result of the change in bank investment policy, together with the unusually small supply of new corporation securities that has come into the market during the past few years, almost all of the increase in bank investments has been in Government securities.

Institutional investments. A study of the changes in the assets and liabilities of other institutions that provide channels for the investment of the savings of the public indicates some reduction in the rate of increase in the total volume of savings administered by such institutions, as compared with predepression years. As in the case of commercial banks, however, these institutions show a considerable degree of concentration of investment in Government securities.

In mutual savings banks, for instance, the growth of deposits during the past few years has been at a rate much slower than in the 1920's—a rate of growth, in fact, which has been less than interest accumulations on deposits previously held. Investments in corporation securities by such banks declined substantially between the middle of 1931 and the middle of 1932, and subsequently have continued to show a gradual shrinkage. Since 1931 increases in the investments of savings banks have taken the form almost exclusively of purchases of Government direct obligations and Government guaranteed securities.

The savings represented by life insurance company reserves have continued to show a rapid rate of growth during recent years; the annual increases recently, in dollar amounts, have been practically as large as they were ten years ago, although the percentage rate of increase has been somewhat smaller. Data on life insurance company investments indicate that, in this case also, the largest increase in recent years has been in Government securities. Purchases of corporation securities by such companies during the past few years have been of even greater magnitude than in the late 1920's, but investments in real estate mortgages have been greatly reduced. Furthermore, it should be borne in mind that, as life insurance companies are strictly limited in their investments to high grade securities, their purchases of new corporation bonds have provided funds only for strong companies of high standing.

Building and loan associations have shown a gradual but persistent decline in the volume of savings which they have held for investment chiefly in real estate mortgages.

An increasing proportion of the savings of the country during recent years has been in funds administered by the Federal Government—the postal savings system, social security funds, including the old age reserve account and the civil service and railroad retirement funds, and also unemployment insurance trust funds collected by the States, which are transferred to the Federal Treasury for investment in Government securities. Furthermore, United States savings bonds have provided a channel for direct investment of savings in Government securities, amounting in recent years to from four to five hundred million dollars a year.

Altogether investments of savings in United States Government direct and fully guaranteed obligations through the various channels reviewed above appear to have been in the neighborhood of $17,000,000,000 in the last five years, including the investments of commercial banks in such securities. Meanwhile the net increase in investments in corporation securities from all these sources, including commercial banks, apparently has been about $1,100,000,000. A considerably larger increase in holdings of corporation securities by life insurance companies has been partly offset by the reduction in holdings of such securities by other institutions. All of the increase has been in holdings of high grade bonds. None of these institutions is now investing any appreciable amounts in lower grade bonds or in stocks. In fact, most of them are prohibited by law from making such investments.

Consequently, the principal remaining source of funds for private enterprise that involves a material degree of risk is the direct investment of private savings from both large and small investors. In fact, over the whole period of our present economic system, that has been one of the most important sources of "risk capital." In recent years, however, the supply of funds from that source has been greatly reduced. At the bottom of the depression in 1932, the aggregate amount of individual incomes of $50,000 and over, after payment of Federal income taxes, was about $620,000,000 as compared with about $5,400,000,000 in 1928, a reduction of more than 85 per cent, and in 1937, the latest year for which such records are available, the amount was about 20 per cent of the volume in 1928. Not only has the amount of savings from large incomes available for investment been greatly reduced, but the high rates of taxation in the upper brackets in recent years have provided an incentive for the diversion of a considerable part of such savings from the financing of private enterprise to investments in tax exempt Federal, State, and municipal securities. Even among investors with smaller incomes, who are not subject to such high rates of taxation, there is reported to have been a disinclination, in recent years, to invest in any corporation securities involving a substantial measure of risk, in view of the wide fluctuations in market values, and the great reduction in the profits of most corporations during recent years, as compared with the prosperous years of the 1920's. Many private investors, apparently, do not consider the prospect of profits from venturesome investments in private enterprise sufficient to outweigh the risk of losses.

Still another obstacle to the raising of additional capital by private enterprise, which applies especially to small concerns, is the high cost of selling new issues of their securities. The uncertainties involved in the marketing of such securities tend to make underwriting costs very high relative to the size of the issues. Furthermore, public offerings involve substantial expenses for the legal and accounting services required for the preparation of registration statements to be filed with the Securities and Exchange Commission. Direct sales of new securities by small corporations to local banks were also made difficult, until recently, by rules of bank supervisory authorities requiring banks to limit their investments to readily marketable securities. Those rules, however, were relaxed in June, 1938.

Altogether, events of recent years, economic, political, and financial, have tended to increase the flow of investment funds into Government, State, and municipal securities, and other securities of the highest grade, and to restrict the flow of investment into private enterprise where a material degree of risk is involved. Either the hesitation of capital to flow into new enterprises, or the diminution of opportunity to invest in them, or both, will remove an important force for recovery, one which has proved most effective in all of our past experiences. It will be impossible to answer the question whether there are in fact diminished opportunities until the hesitation of private capital to invest in them is overcome.

Demands for Credit and Capital

The continued recession in business activity during the early months of 1938 was accompanied by a fairly substantial reduction in the commercial loans of member banks and although the recession was checked in June, the decline in loans continued seasonally until early August. For the first seven months of the year, the reduction in such loans for weekly reporting member banks in New York City was approximately 19 per cent, and for all weekly reporting member banks approximately 15 per cent. This reduction apparently resulted largely from further progress in the liquidation of business inventories, which had reached high levels in the early part of 1937, together with smaller requirements for funds to finance the diminishing volume of business.

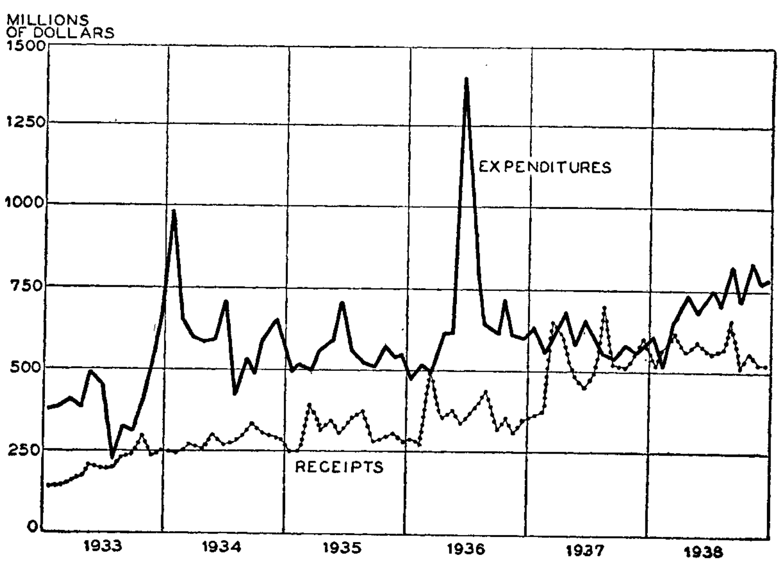
Despite the vigorous upturn in business activity in the latter half of the year, and the usual seasonal financing of crop movements and autumn trade during that period, there was little increase in the total volume of agricultural, commercial, and industrial loans at the weekly reporting member banks. This experience is not unusual, however, as it has been observed frequently in the past that the appearance of a net increase in loans tends to lag after an upturn in business. Presumably this is due to continued liquidation of old loans in the early stages of recovery, and to the conversion of inventories into cash by some business organizations, which provides sufficient funds to finance the first stages of business expansion. Another factor which tended to prevent an expansion in business loans in the latter half of the year was the use of the proceeds of certain new security issues for the repayment of bank loans, especially in New York.

Loans for the purpose of financing security trading also showed further liquidation during the first five months of the year, accompanying continued decline in security prices during that period. Subsequently, beginning in June, there was an upturn in security prices and a gradual increase in loans, reflecting a moderate expansion of margin accounts, and also, near the end of the year, a temporary increase in the borrowings of security brokers and dealers. Direct loans by the reporting banks to finance security trading by their customers, however, showed no expansion during the latter part of the year, and, for the year as a whole, there was a small net reduction in the total volume of security loans.

Real estate loans and personal and other miscellaneous loans showed practically no net change for the year. Altogether, the total loans of the weekly reporting member banks showed a net reduction for the year as a whole. The principal outlet for bank credit during the year, as for some time past, was investment in securities.

Increase in Government Borrowing

While corporation financing in the security markets revived somewhat from the low levels of the latter half of 1937, the principal borrower in 1938, as in a number of preceding years, was the Federal Government. Total cash receipts and expenditures of the Government were nearly in balance during the first three months of the year, but, as the accompanying diagram indicates, expenditures subsequently increased substantially while receipts declined gradually. There was a new program of Government spending to promote business recovery, and to meet increased needs for relief, which raised total disbursements to record levels (except for the period when veterans' bonus payments were at their maximum in 1936 and one month at the height of the Civil Works Administration program in 1934). Receipts, therefore, fell considerably short of expenditures after March. In reviewing the figures shown in this



Cash Receipts and Expenditures of the United States Government

diagram, it should be noted that the data differ from the figures on Government receipts and expenditures shown in current Treasury statements. The figures in the diagram on total receipts are adjusted to show cash receipts from all sources, excluding new issues of Government securities, but including items such as receipts of unemployment insurance trust funds from the States. Total disbursements are adjusted to exclude items such as transfers to trust accounts, which do not represent actual cash outlays. Income tax and other receipts that are payable quarterly, as well as interest payments on the National debt, have been distributed over three month periods to smooth out temporary fluctuations and give clearer indication of the trends in receipts and expenditures.

The first form of Government disbursements to show an increase during 1938 was repayments of unemployment insurance trust funds to certain States where unemployment benefits became payable at the beginning of the year. Disbursements of this kind were in the neighborhood of 35 million dollars a month during 1938. There were also increases in disbursements under the Agricultural Adjustment Act, and in expenditures for the National defense, but by far the largest increase was in expenditures under the Works Progress Administration program, designed to provide employment for many of those who were released from private employment during the first half of the year. The construction projects authorized by the Public Works Administration reached very large volume in the latter part of the year, but actual cash disbursements for these projects were comparatively small, leaving the greater part of such expenditures to be made during 1939.

In the early months of this expansion of Government expenditures, no sales of new Government securities were required because of the large Treasury balances in Federal Reserve Banks which resulted from the release of unused gold in the Treasury. In September, however, the Treasury followed the policy of borrowing funds in advance of actual needs. There was still available at that time a large volume of funds in the form of Treasury balances in the Reserve Banks and free gold in the Treasury, but the additional funds obtained through security sales strengthened the Treasury cash position still further. The new securities sold in September amounted to approximately $800,000,000, and on December 15 the Treasury sold an additional $700,000,000 of new securities.

Holdings of direct obligations of the Government, by weekly reporting member banks in principal cities, increased approximately $610,000,000 during the last five months of the year, but as there had been a preceding decline of about $360,000,000 during the first seven months of the year, the net increase for the year as a whole was only about $250,000,000. The principal New York City banks, in fact, had a net reduction of about $200,000,000 in their holdings of direct Government obligations, which apparently was due chiefly to the retirement of a rather large volume of Treasury bills, of which the New York City banks were important holders. This retirement of Treasury bills occurred in connection with the adoption of a program, completed at the end of August, of issuing only bills of three months' maturity, in the amount of $100,000,000 weekly. The total amount of bills which can be outstanding under this program is $1,300,000,000. Formerly Treasury bills were sold with maturities of as much as nine months, and the total outstanding has been as high as $2,650,000,000. Reporting member banks in 100 other principal cities outside New York increased their holdings of direct obligations of the Government by slightly more than $450,000,000 during the year.

A moderate amount of securities was issued by the Reconstruction Finance Corporation and the Commodity Credit Corporation in 1938, and holdings of securities fully guaranteed by the Federal Government increased by nearly $500,000,000 in New York City banks during the year, and by about one-fourth of that amount in other weekly reporting banks. Both groups of banks also showed moderate increases in their holdings of other securities, presumably chiefly State and municipal issues.

Altogether, the total loans and investments of the large New York City banks showed a small net reduction during 1938, but reporting member banks in other principal cities showed an aggregate increase of about $300,000,000, or about 2¼ per cent.

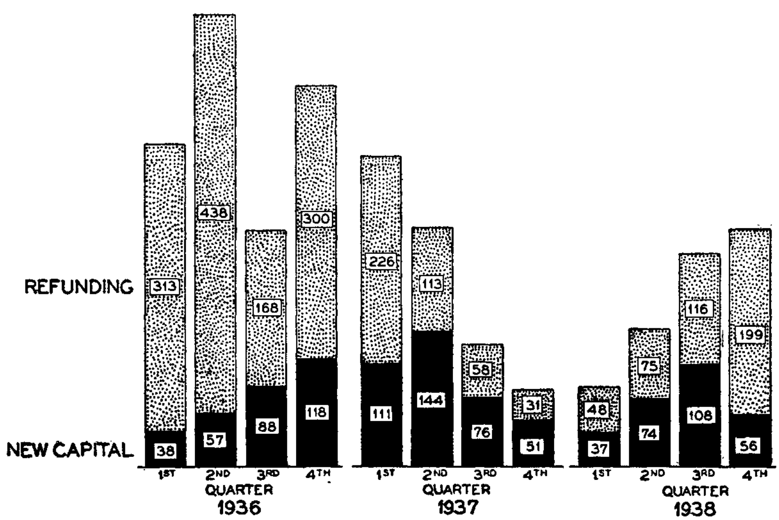
New Security Issues

The condition of extreme ease in the money market which persisted throughout 1938 was favorable to the sale of high grade securities at low interest cost. There was in fact a moderate revival in the flotation of corporation securities, starting practically from the beginning of the year. As the accompanying diagram indicates, however, the volume of such issues at no time in 1938 reached such volume as in 1936 and the early part of 1937. The total volume for the year was 12 per cent less than in 1937, and was 53 per cent less than in 1936 when refunding issues to take advantage of low money rates reached their maximum.

The security issues during the first three quarters of the year included a fairly substantial proportion of issues sold for the purpose of providing the borrowers with new capital, but in the last quarter most of the new issues were for refunding purposes. The volume of new capital provided through the security markets for business enterprise in 1938 was less than in 1936 or 1937, and remained far short of the volume provided in that manner in the period preceding the great depression.

The securities sold during 1938 were largely issues of substantial size and of high grade. While high grade securities of large corporations sold freely and at low interest rates, the market for issues by borrowers, other than large, well known corporations in strong position, continued to be thin.

Many of the new security issues during 1938 were sold directly by the borrowers to insurance companies (or to insur-



Average Monthly Volume of Domestic Corporate Security Issues for New Capital and for Refunding
(In millions of dollars)

ance companies and banks), thus avoiding the necessity of preparing registration statements to be filed with the Securities and Exchange Commission, and also avoiding the charges of investment houses for underwriting the issues. The direct sales also enabled the insurance companies to acquire a larger share of desirable new issues than they would probably have been able to obtain from underwriters, who would have offered them to various institutions among their clientele. It is estimated that insurance company holdings of corporation securities during 1938 increased by an amount almost equal to the volume of new capital raised by business organizations through security sales during the year.

Needs of Small Business for Credit or Capital

Particular attention has been directed during the past year to ascertaining the extent of needs of small concerns for additional credit or capital.

In this District the Smaller Business Association for New York, New Jersey, Connecticut, Inc., sent out last April a questionnaire to ascertain the credit needs of small businesses in this area. About 6,000 replies were received. After reviewing the replies, the Association's banking committee concluded that about two-thirds either indicated no legitimate need for credit or indicated no sound basis for credit. Approximately 13 per cent were quite indefinite as to the character of their needs for credit, but the remaining 20 per cent were classified in three groups as to their apparent merit as prospective borrowers. It was decided that, in order to obtain more specific information as to the possibility of supplying credit in these cases, the Federal Reserve Bank of New York would be asked to investigate 100 cases out of approximately 300 that appeared to be most meritorious. The principals of these 100 concerns were invited by this bank to come in for a discussion of their problems and were also urged by the Association's banking committee to do so. In 45 cases there was no response to this invitation. Of the 55 that did respond, replies were received from five indicating that they were no longer in need of credit accommodation, four submitted financial statements which indicated that they could reasonably expect to obtain credit assistance from their own banks, and four others appeared to be already obtaining adequate credit accommodation from their banks. In the remaining 42 cases, the condition of the businesses of all but eight was such that they could not be encouraged to make formal application to this bank for loans. The eight just referred to appeared to have some merit, and were invited to file applications with this bank. Only one did so and the application was approved. Subsequently, however, a member bank which had offered to participate in making this advance decided to make the loan without the need of participation by the Federal Reserve Bank of New York.

It appears that in a number of other cases the small businesses that replied to the Association's banking committee, indicating a need for credit, had already filed applications with the Reconstruction Finance Corporation office in this District. The experience of the Corporation with these applications appears to have been similar to that of this bank. On the whole, therefore, it was concluded that very few legitimate cases of unsatisfied demands for credit or working capital, which can be extended on a reasonably sound basis, exist in this District.

The inquiry just referred to was concerned primarily with needs for credit or working capital, rather than permanent additions to the proprietary capital of business concerns. A review of approximately 750 applications for working capital that have been declined by this bank during the past four years indicates that in a large percentage of cases the need was for permanent additions to capital rather than intermediate term loans for working capital. The condition of the businesses, however, indicated that the supplying of additional capital in these cases would entail a high degree of risk in most instances. This conclusion is not surprising in view of the fact that each year about 20 per cent of all corporations suspend operations, while approximately the same number of new businesses are started.

Industrial Loans of This Bank

Inquiries from business organizations concerning the possibility of obtaining loans of working capital from this bank, under Section 13b of the Federal Reserve Act, increased substantially in the first quarter of 1938, accompanying the severe recession in business activity and profits, and the total for the quarter was greater than in any similar period since the third quarter of 1935. During succeeding quarters of 1938, however, the number of inquiries diminished rapidly. As some time elapses between the initial inquiries and the filing of formal applications, the number of such applications received reached its maximum in the second quarter, but in this case also there was a rapid decline during the remainder of the year.

Quarterly Period	Inquiries	Applications
1934		
June to September	1,754	277
October to December	658	258
1935		
January to March	362	161
April to June	291	114
July to September	372	124
October to December	234	87
1936		
January to March	215	72
April to June	118	55
July to September	74	28
October to December	47	28
1937		
January to March	35	20
April to June	29	14
July to September	21	8
October to December	34	10
1938		
January to March	299	42
April to June	207	50
July to September	131	30
October to December	56	9
Total	4,937	1,387

As in preceding years, it was found that in a considerable percentage of cases the inquiries were for loans that would be ineligible for this bank to make under the section of the law referred to above, or the situation of the prospective borrowers offered little hope that loans could be made on a sound basis. In fact, it was observed during the past year that the quality of applications received in general was not as good as in preceding years. The reason for this appears to be that it is now easier for prospective borrowers, whose condition and prospects appear to be reasonably satisfactory, to obtain working capital from other sources. Commercial banks have increasingly engaged in the practice of making loans of 1 to 5 year maturities, and it appears that the attitude of bank examiners has become more favorable to such loans, provided that they are made on a sound basis.

As a result of the poorer quality of applications received during 1938, the ratio of approvals to declinations of applications by this bank was lower than in preceding years. The disposition of all applications received between June 19, 1934, when the Federal Reserve Banks were first authorized to make these working capital loans, to the end of 1938, is summarized in the following table.

	Up to Dec. 31, 1938
Applications approved and advances or commitments made......	358
Applications approved but withdrawn by applicant after approval	156
Applications approved and awaiting closing..................	2
Total applications approved.....................	516
Applications declined	796
Applications withdrawn before consideration..................	72
Applications on hand awaiting consideration..................	3
Grand total	1,387

At the close of the year, 263 loans totaling $14,000,000 had been repaid in full, and partial repayments aggregating $4,900,000 on an additional 83 loans had been received, leaving a total of $7,300,000 to be paid on 95 loans and commitments. The total of loans made up to the end of 1938 was $26,200,000.

A recent review of the results of the industrial loans made by this bank, either directly or in conjunction with commercial banks, indicated that, on the whole, these loans had been helpful to the borrowers, and beneficial to their respective communities through the maintenance or increase of employment in the plants of the borrowers. While a little over one-fifth of the borrowers showed continued deterioration of their position since receipt of the loans, nearly two-thirds showed definite improvement. In an additional 15 per cent of the cases the borrowers appeared to have benefited only temporarily, although the eventual outcome in a number of these cases was still in doubt at the time of the review.

As a banking operation, the lending of working capital by this bank has not been profitable. Gross earnings on these loans at the end of 1938 amounted to approximately $1,450,000, and net earnings, before the establishment of reserves against estimated losses, were $642,000. These net earnings were not sufficient to provide fully for the reserves set up against estimated losses, which at the end of 1938 aggregated $915,000; the remainder was obtained chiefly from the special surplus account which had been created previously in connection with the industrial loan operations of this bank.

Federal Reserve Policy

The principal expression of Federal Reserve policy during 1938 was the reduction in member bank reserve requirements by the Board of Governors, effective April 16, mentioned on pages 6 and 7 of this report. This action was taken as a part of the Government's program of promoting recovery, announced in April when business activity was still declining, and, together with the release of inactive gold by the Treasury, served to increase substantially the large supply of available funds in member banks.

The total amount of Government securities in the System Open Market Account was maintained at $2,564,000,000 during 1938. Changes were made in the maturity distribution of securities held in the Account, both by purchases and sales in the market and by the exchange of maturing issues for new issues offered by the Treasury at quarterly financing dates. The operation of the Account during the year showed no change in Federal Reserve policy.

In the latter part of December an unusual situation arose in the Treasury bill market. The volume of such bills available in the market had declined from $1,950,000,000 at the beginning of the year to $1,300,000,000 on August 31, when issues were limited to $100,000,000 of three month bills each week. Toward the year end there was a special demand for Treasury bills for statement purposes, which continued into January as the bills came into demand to reduce tax liabilities on State tax dates. As previously noted, the last issue of Treasury bills in December, was sold at par or better, and the outlook then was that this situation would persist well into January. In addition, the market for short term Treasury notes was distorted by the value given to those notes as prospective "rights" in connection with subscriptions to new issues of Government securities, so that notes with maturities of less than two years were selling on a no yield basis. In the circumstances, it was impractical to replace maturing bills in the System Account with newly issued bills, or with short term notes. In view of this situation, the following statement was issued on December 30, at the close of a meeting of the Federal Open Market Committee in Washington:

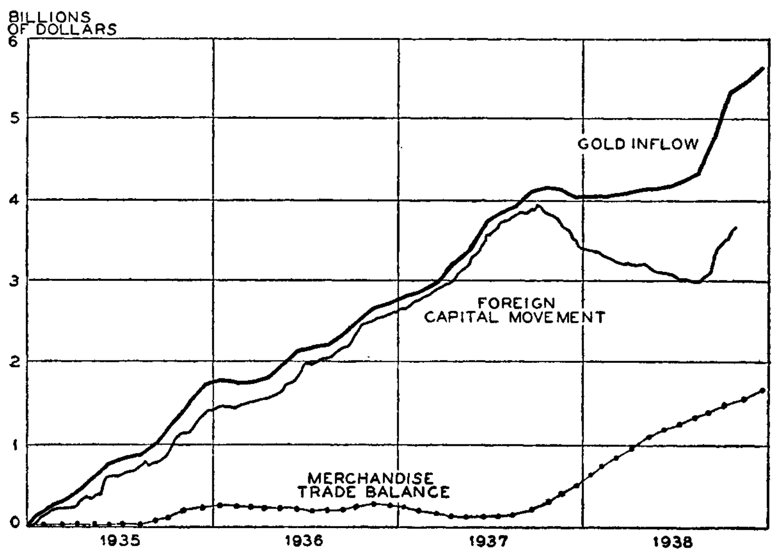
> The Federal Open Market Committee announced, following a meeting today, that weekly statements of the total holdings in the Federal Reserve System's Open Market Account may at times show some fluctuation depending upon conditions in the market affecting the Committee's ability to replace maturing Treasury bills held in its portfolio. The volume of Treasury bills available on the market has declined materially during the year and, owing to the large and increasing demand, such bills are already selling either on a no yield basis or at a premium above a no yield basis. It has, therefore, become difficult and in some weeks impossible for the System to find sufficient bills on the market to replace those that mature. Short term notes are also selling on a no yield basis and longer term notes have at times been difficult to obtain. In these circumstances, it may be necessary from time to time to permit bills held in the portfolio to mature without replacement, not because of any change in Federal Reserve policy but solely because of the technical situation in the market. Because no change in Federal Reserve policy is contemplated at this time, maturing bills will be replaced to the extent that market conditions warrant.

The record of the meeting of the Federal Open Market Committee on that date, subsequently published, indicated that its executive committee was then directed to replace maturing Treasury bills in the System Open Market Account with other Treasury bills or Treasury notes, only to the extent that such replacements could be made without paying a premium over a no yield basis, or to the extent that Treasury notes could be obtained without undue disturbance to the note market. Actually, replacements continued to be made.

The discount rate of this bank remained unchanged throughout the year at 1 per cent.

The Foreign Exchanges and Capital and Gold Movements

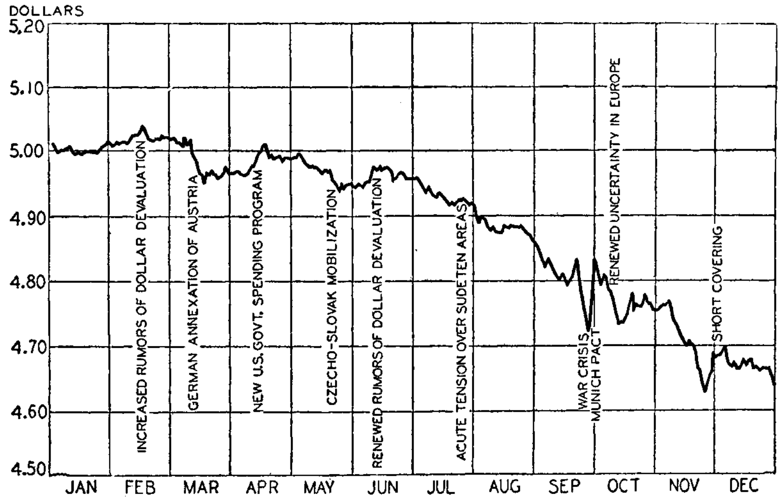
During 1938 the dollar appreciated substantially in the foreign exchange market as a consequence first of the heavy export balance in merchandise trade, and second of a large flight of capital to the United States in the last five months of the year because of the fear of war in Europe. The heavy trade surplus, up to the end of July, was offset, in part, by gold shipments to the United States but, principally, by the disbursement by foreigners of their dollar balances acquired in previous years. After July, when foreigners wanted dollars not only for the purchase of American goods but also for the accumulation of funds away from European centers and probably for investment and speculative purposes as well, the movement of gold to this country took place at a rate more rapid than any previously experienced. Over the year as a whole, the net merchandise export surplus of this country amounted to $1,134,000,000, and the net reported gain of gold from abroad was $1,640,000,000. Data on capital movements between the United States and other countries, which have been made public through November, 1938, indicate that the capital inflow in the four months of August, September, October, and November was sufficiently rapid to exceed by $299,000,000 the reduction in



Principal Factors Causing Gold Inflow into the United States
(Cumulative movements of gold, foreign capital, and excess of merchandise exports over imports since January 1, 1935. Data on foreign capital movement through October of 1938)

foreign funds here during the preceding seven months. A further capital inflow was reported to have occurred in the final month of the year.

The strength of the dollar in foreign exchange quotations can be illustrated by its course against the pound sterling. From an opening rate of \$5.00 3/8 on January 3, the pound went to a high of \$5.03 7/8 on February 16 under the influence of rumors, which had been current in Europe since early October, 1937, that the dollar would be devalued as a recovery measure. From this level the pound went as low as \$4.93 7/8 close to the end of May in response to fears of war in Europe, engendered by the German annexation of Austria on March 13 and the Czecho-Slovak mobilization of May 21. It recovered to \$4.98¼ in mid-June in response to the recurring rumors abroad of imminent dollar devaluation. From June 15 until September 28, sterling fell continuously as the European political scene became more critical, reaching a low of \$4.61 in this market on September 28. After an abrupt recovery to \$4.81 13/16 following the Munich Conference, however, the pound sagged again as second thoughts on the Munich pact, the German campaign against the Jews, and Italian claims against France raised the question whether the Munich agreement was, in fact, an assurance of lasting peace of Europe. From a level of \$4.62⅝ on



Fluctuations in Sterling Exchange at New York during 1938, Showing Various Factors, which, in Addition to the Large Merchandise Export Balance of the United States, Affected the Rate (Daily closing rates)

November 26, sterling recovered to $4.70, principally under the impact of short covering prior to the year end. In the last few days of the year, renewed selling sent sterling to $4.64 on December 31, so that the net decline for the year was $0.36, or 7 per cent.

The fall in the pound during the year was accompanied by the rise in the London gold price in terms of sterling from 139s 5d on January 3 to 150s on November 26, a record high price. The dollar equivalent of the London gold price remained above the level at which gold shipments to New York could profitably be undertaken for practically all of the first seven months of the year, reaching a high of $35.19 ¼ on February 18. It then declined, reaching the New York shipping "parity" of about $34.76 ½ by August 3, and held close to that level throughout the remainder of the year, except for two weeks in September when the shipping point itself was reduced by several successive sharp increases in war risk insurance premiums. On this account the dollar equivalent of the London gold price fell, at the height of the crisis on September 28, to $34.25⅛, the lowest since January, 1935. It recovered, however, to $34.77 on October 1.

Closing Cable Rates at New York

Exchange on	January 3	High	Low	December 31
Belgium	$.1698	$.1704	$.1673	$.1684
Denmark	.2237	.2248	.2066	.2072
England	5.0106	5.0375	4.6288	4.6400
France	.0340	.0340	.0259	.0262
Germany	.4029	.4055	.3971	.4014
Italy	.0526	.0527	.0526	.0526
Netherlands	.5576	.5616	.5330	.5440
Norway	.2517	.2531	.2325	.2333
Sweden	.2583	.2596	.2384	.2391
Switzerland	.2318	.2331	.2238	.2255
Canada	.9997	1.0006	.9812	.9902
Argentina, Official	.3339	.3377	.3085	.3095
Argentina, Free	.2936	.2943	.2250	.2272
Brazil	.0522	.0595	.0521	.0586
Uruguay	.8000	.8000	.6103	.6108
Japan	.2915	.2920	.2700	.2709
India	.3785	.3806	.3456	.3474
Shanghai	.2963	.2990	.1590	.1655
Hong Kong	.3131	.3155	.2902	.2912

The French franc also fell sharply against the dollar during the year, going from \$0.0339 5/8 on January 3 to \$0.0262 3/16 on December 31. From the beginning of the year to May 3, the franc declined gradually to \$0.0301 7/8, while the London cross-rate weakened from 147.30 francs per pound to 164.56, as successive cabinets fell in France. On May 5, the Government revalued the franc downward and established a minimum level of 179 francs per pound, then equivalent to \$0.0279 in New York. A substantial repatriation of capital followed this move, but continued adverse trade balances, Treasury difficulties in borrowing, and fears of war led to a renewed drain of capital until November, when, under decree powers the Government presented a recovery program, which initiated a second substantial repatriation of funds.

Among the other European currencies, the belga was subject to sharp speculative attacks, first on the occasion of the downward revaluation of the franc, and second in December in response to internal political difficulties, but both attacks were weathered successfully. The guilder and the Swiss franc declined in roughly parallel fashion to sterling until September, since which time they appear to have been managed independently of the pound and held fairly steady in terms of the dollar. Pegged quotations in Scandinavian currencies were unchanged in terms of the pound sterling. Dealings in the reichsmark and the lira remained subject to stringent official restrictions in Germany and Italy, although quotations for blocked marks fell during the year, and were especially weak in September during the crisis.

Outside Europe, depreciation of the peso continued in Argentina, and foreign exchange restrictions were imposed in New Zealand and tightened in Japan, while both currency depreciation and exchange control supervened in Mexico and China. Local conditions, including excessive merchandise imports for domestic consumption in relation to exports, capital flight, and imports of war materials, were principally responsible for these developments, rather than the state of world markets.

The outward movement of capital in the first seven months of the year, when foreigners, in effect, drew on dollar balances in New York to pay for net merchandise imports from this country, amounted to \$410,000,000, which resulted from a withdrawal of \$443,000,000 in short term banking funds and an inflow of $33,000,000 in security transactions, including changes in brokerage balances. In the four months, August to November inclusive, the inflow of capital amounted to $709,000,000, short term banking funds accounting for $690,000,000 of this amount, and security transactions plus changes in brokerage balances accounting for the remaining $19,000,000. The influx of capital during this period was at the highest rate on record and, in the two weeks ended September 21, near the peak of the European war scare, it reached $288,700,000. After the Munich agreement, foreign buying of American securities took place in October on the most substantial scale in eighteen months, but the movement of short term banking funds in the last month of the year, although it continued inward, was less than half the volume of October.

In the movement of capital to this market over the year, English and French sources, and European countries other than those shown separately in the accompanying table, were the principal contributors to the total inflow, while Far Eastern and Swiss funds were withdrawn from this market, the former

Movement of Capital between the United States and Foreign Countries
December 29, 1937 to November 30, 1938 (a)
(In millions of dollars; capital inflow + or outflow —)

By Source	Short term banking funds	Security transactions (b)	Total
England	+112	+ 9	+121
France	+ 55	+ 10	+ 65
Germany	+ 12	+ 1	+ 13
Italy	+ 1	+ 3	+ 4
Netherlands	+ 1	+ 12	+ 13
Switzerland	— 87	+ 25	— 62
Other Europe	+ 83	+ 49	+132
Total Europe	+177	+109	+286
Canada	+148	— 63	+ 85
Latin America	— 16	— 6	— 22
Far East	— 79	+ 8	— 71
All Other	+ 17	+ 4	+ 21
Total	+247	+ 52	+299
Dec. 29, 1937—July 27, 1938	—443	+ 33	—410
July 28, 1938—Nov. 30, 1938	+690	+ 19	+709

(a) Source: United States Treasury Department. (b) Including the movement in brokerage balances.

to pay for merchandise imports, the latter in connection with gold operations here. The small Latin American outflow included a $25,000,000 bond issue sold by Argentina in this market.

The net reported gain of gold from abroad, resulting from imports, exports, and changes in gold held under earmark for foreign account, amounted to $1,640,100,000. Imports from England reached a total over the year of $1,208,800,000, and Japan, the Netherlands, France, Canada, and Sweden furnished additional substantial amounts. The net gain in the first quarter was $43,100,000, in the second quarter $108,600,000, in the third quarter $687,700,000, and in the fourth quarter $800,700,000. Total net imports of gold aggregated $1,973,600,000, but of this amount $333,500,000, net, was earmarked for foreign account, partly reflecting efforts of European authorities to place some of their metallic reserves away from the area of threatened war. Gold movements during 1938, by countries of origin or destination, are summarized in the accompanying table. Some of the gold receipts shown in this table were earmarked for foreign account upon arrival, but such transactions are not reported by countries.

Gold Movements by Countries
(In thousands of dollars)

Country	Exports to	Imports from	Net
Argentina	....	31,831	31,831
Australia	....	39,162	39,162
Belgium	....	15,488	15,488
Canada	115	76,430	76,315
Colombia	....	10,558	10,558
England	73	1,208,802	1,208,729
France	5,000	86,136	81,136
India	....	16,160	16,160
Japan	....	168,740	168,740
Mexico	697	37,169	36,472
Netherlands	....	163,049	163,049
Philippines	2	27,882	27,880
Sweden	....	60,146	60,146
All Other	2	37,904	37,902
Total	5,889	1,979,457	1,973,568

Foreign Relations

During 1938 the accounts maintained at this bank for the Austrian National Bank and the Central Bank of Bolivia were closed, the former being liquidated on April 28, 1938, and the latter closed, at the request of the Central Bank of Bolivia, on April 18, 1938. The total number of foreign banks of issue for which accounts are maintained was thereby decreased to forty, including the Bank for International Settlements. Balances maintained by foreign correspondents with this bank stood at $199,211,000 at the end of 1938, as compared with $171,750,000 at the end of 1937, and $98,620,000 at the close of 1936. In addition, $628,587,000 of gold was held under earmark for foreign correspondents on December 31, 1938, as compared with $295,130,000 a year previous. The total of earmarked gold near the end of December, 1938, was larger in dollar value than at any previous time.

In behalf of the twelve Federal Reserve Banks, one short term loan, secured by gold, was extended to a foreign central bank during 1938 in the amount of $80,000. This loan was made in January, 1938, for a period of four months, and was repaid before maturity.

As the result of partial repayments of principal, the participation of the Federal Reserve Banks in the credit originally extended jointly by a group of central banks and the Bank for International Settlements to the National Bank of Hungary in 1931, was reduced from $2,282,000 at the close of 1937 to $2,055,000 at the end of 1938.

The balances held abroad by this bank in its own behalf and in behalf of the other Federal Reserve Banks were reduced slightly during 1938 from an aggregate amount equivalent to $179,000 to the equivalent of $172,000; of the latter amount $85,000 is repayable in United States dollars and the remainder in foreign currencies. Total holdings of commercial bills denominated in foreign currencies amounted to $549,200 at the end of 1938, exclusive of the Hungarian credit referred to above. Of this amount $466,400 is repayable in United States dollars.

Operations of the Bank During 1938

Data on the volume of work, the types of which can be measured readily, are shown in the following table for the year 1938 compared with 1937. Reflecting in part the lower level of business activity during 1938 than in 1937, the volume of operations of this bank in general showed some reduction for the year. An exception was in the handling of checks, the number of which increased slightly, notwithstanding a decrease in the dollar volume; the number of checks handled has been increasing

	1938	1937
Number of Pieces Handled		
Bills discounted:		
Applications	1,912	2,751
Notes discounted	2,174	4,167
Industrial advances:		
Notes discounted	125	93
Commitments to make industrial advances	14	57
Bills purchased in open market †	158	1,252
Currency received and counted	645,229,000	683,487,000
Coin received and counted	880,939,000	1,022,766,000
Checks handled	199,324,000	195,892,000
Collection items handled:		
United States Government coupons paid *	4,971,000	4,990,000
All other	2,026,000	2,111,000
Issues, redemptions, and exchanges by fiscal agency department:		
United States Government direct obligations	1,080,000	1,064,000
All other	360,000	395,000
Wire transfers of funds	209,000	243,000
Amounts Handled		
Bills discounted	$87,161,000	$207,289,000
Industrial advances:		
Notes discounted	973,000	2,036,000
Commitments to make industrial advances	1,789,000	2,254,000
Bills purchased in open market for own account	1,091,000	8,809,000
Currency received and counted	2,971,426,000	3,268,841,000
Coin received and counted	89,189,000	105,552,000
Checks handled	70,471,328,000	77,897,043,000
Collection items handled:		
United States Government coupons paid *	496,769,000	493,835,000
All other	1,725,713,000	1,881,825,000
Issues, redemptions, and exchanges by fiscal agency department:		
United States Government direct obligations	17,958,369,000	13,536,635,000
All other	1,995,611,000	1,407,081,000
Wire transfers of funds	27,498,995,000	32,765,514,000

† Includes number purchased by this bank for System account.

* Includes coupons from obligations guaranteed by the United States.

steadily since 1933, and in the last two years has exceeded the number handled in 1929. Items which showed a reduction during the year, both in number and dollar volume, were currency and coin received and counted, bills purchased, bills discounted, collection items other than United States Government coupons paid, and wire transfers.

Activity by this bank as fiscal agent for the Government in the issue, redemption, and exchange of United States Government direct obligations showed a sharp increase in dollar volume, with only a slight increase in number of pieces handled, indicating an increased proportion of transactions in securities of the larger denominations. Operations conducted for other Government agencies showed a reduction in number of pieces handled, but an increase in the dollar amount.

Financial Statement

The following statement of condition of this bank compares assets and liabilities at the end of 1938 with a year previous. As this statement indicates, the principal change in the earning assets of the bank during 1938 was an increase in holdings of Government securities, reflecting an increased participation by this bank in the System Open Market Account. (The total holdings of the account are periodically reallocated among the twelve Federal Reserve Banks.) The volume of discounts for member banks declined during 1938 following an increase during 1937, and on December 31 was lower than at the end of any preceding year since 1915, the first complete year of the bank's operations. Total reserves were greatly increased during the year, accompanying the increase in the gold stock of this country and the release of inactive gold by the Treasury.

The volume of Federal Reserve notes of this bank in actual circulation showed a further increase during the year, and deposit liabilities reached a new high level, chiefly as a result of the large increase in member bank reserve accounts.

(In thousands of dollars)

Assets	Dec. 31, 1938	Dec. 31, 1937
Gold certificates on hand and due from U. S. Treasury	$5,115,945	$3,586,484
Redemption Fund—Federal Reserve notes	1,226	1,124
Other cash	103,924	78,420
Total reserves	$5,221,095	$3,666,028
Bills discounted:		
Secured by U. S. Government obligations, direct or fully guaranteed	$ 804	$ 2,804
Other bills discounted	241	316
Total bills discounted	$ 1,045	$ 3,120
Bills bought in open market	$ 215	$ 212
Industrial advances	3,879	4,412
U. S. Government securities:		
Bonds	$ 267,426	$ 216,814
Treasury notes	367,938	333,211
Treasury bills	180,058	189,679
Total U. S. Government securities	$ 815,422	$ 739,704
Total bills and securities	$ 820,561	$ 747,448
Due from foreign banks	$ 65	$ 68
Federal Reserve notes of other banks	5,337	5,292
Uncollected items	207,064	195,811
Bank premises	9,038	9,973
Other assets	13,388	10,808
Total assets	$6,276,548	$4,635,428

(In thousands of dollars)

Liabilities	Dec. 31, 1938	Dec. 31, 1937
Federal Reserve notes in actual circulation....	$1,029,296	$ 964,902
Deposits:		
Member bank—reserve account............	$4,460,340	$3,071,762
U. S. Treasurer—General Account..........	212,295	39,295
Foreign bank	71,368	60,892
Other deposits	188,480	189,134
Total deposits	$4,932,483	$3,361,083
Deferred availability items....................	$ 194,382	$ 189,511
Other liabilities	1,214	977
Total liabilities	$6,157,375	$4,516,473
Capital accounts:		
Capital paid in..........................	$ 51,043	$ 51,058
Surplus (Section 7)	52,463	51,943
Surplus (Section 13b)	7,457	7,744
Other capital accounts....................	8,210	8,210
Total capital accounts.................	$ 119,173	$ 118,955
Total liabilities and capital accounts....	$6,276,548	$4,635,428
Ratio of total reserves to deposit and Federal Reserve note liabilities combined...........	87.6%	84.7%
Contingent liability on bills purchased for foreign correspondents	$ 27	$ 582
Commitments to make industrial advances.......	2,677	4,754

Income and Disbursements

Total current earnings of this bank were $842,000 less in 1938 than in 1937, and as expenses were only slightly smaller current net earnings showed a reduction of $827,000. The reduction in earnings, notwithstanding the increase in the amount of securities held, was due to lower yields on United States Government securities. The additions to current net earnings, principally profits of $2,316,000 on sales of Government securities, were somewhat exceeded by deductions from current net earnings for the retirement system, for reserves, and for charge-offs on bank premises. Net earnings were $3,291,000, and, after providing for regular dividends of $3,057,000 to member banks, and transferring $286,000 from the special surplus account (Section 13b) to cover part of the reserves set up against estimated losses on loans to industrial concerns, $520,000 net was transferred to the ordinary surplus account (Section 7).

Profit and Loss Account
For the calendar years 1938 and 1937
(In thousands of dollars)

	1938*	1937
Earnings	$ 10,706	$ 11,548
Net expenses	7,336	7,351
Current net earnings	$ 3,370	$ 4,197
Additions to current net earnings:		
Profits on sales of U. S. Government securities	$ 2,316	$ 664
All other	83	55
Total additions	$ 2,399	$ 719
Deductions from current net earnings:		
Losses and reserves for losses on industrial advances (net)	$ 448	$ 206
Special reserves and charge-offs on bank premises	737	
Prior service contributions to retirement system (final payment)	1,282	639
Assessment for building for Board of Governors of the Federal Reserve System		514
All other	11	13
Total deductions	$ 2,478	$ 1,372
Net deductions from current net earnings	$ 79	$ 653
Net earnings	$ 3,291	$ 3,544
Paid United States Treasury (Section 13b)	$	$ 5
Dividends paid	3,057	3,070
Transferred from surplus (Section 13b)	286	
Transferred to surplus (Section 7)	520	469
Surplus (Section 7) beginning of year	$ 51,943	$ 51,474
Addition as above	520	469
Surplus (Section 7) end of year	$ 52,463	$ 51,943

*Some figures for 1938 have been revised since the preliminary publication of the annual statement of this bank on January 7, 1939, chiefly to reflect the amounts transferred to reserve for estimated losses on industrial loans from surplus (Section 13b) and to surplus (Section 7).

Membership Changes in 1938

There were very few changes in membership in this District during the year—only three mergers among member banks and one voluntary liquidation. No National banks were organized during the year, nor were any additional State banks or trust companies admitted to membership. The number of member banks in percentage of total commercial banks in the Second Federal Reserve District remained unchanged at 75 per cent.

The tables below show the classification of banks in this District according to their charters, and the record of changes in membership during 1938.

Number of Member and Nonmember Banks in Second Federal Reserve District at End of Year

Type of Bank	December 31, 1938			December 31, 1937		
	Members	Non-members	Per cent members	Members	Non-members	Per cent members
National banks	599	0	100	603	0	100
State banks *	44	110	29	44	111	28
Trust companies	129	147	47	129	147	47
Total	772	257	75	776	258	75

* Excludes Savings banks.

Changes in Federal Reserve Membership in Second District During 1938

Total membership beginning of year	776
Increases:	
None	0
Decreases:	
Member banks combined with other members	3
Voluntary liquidation	1
Total decreases	4
Total membership end of year	772

Changes in Directors and Officers

Edward K. Mills, President, Morristown Trust Company, Morristown, N. J., a director of this bank since January, 1933, died March 10, 1938.

At a special election in May, 1938, Otis A. Thompson, President, The National Bank and Trust Company of Norwich, Norwich, N. Y., was elected by member banks in Group 2, as a Class A director to hold office for the unexpired term of Mr. Mills ending December 31, 1938.

At a regular election during the autumn of 1938, Otis A. Thompson was reelected by member banks in Group 2 as a Class A director for a term of three years beginning January 1, 1939, and Walter C. Teagle, Chairman, Board of Directors, Standard Oil Company (New Jersey), New York, N. Y., was reelected by member banks in Group 2 as a Class B director for a term of three years beginning January 1, 1939.

On January 19, 1938, the Board of Governors of the Federal Reserve System designated Owen D. Young, Chairman, Board of Directors, General Electric Company, New York, N. Y., Chairman and Federal Reserve Agent of this bank for the remainder of the year, and designated Beardsley Ruml, Treasurer, R. H. Macy & Co., Inc., New York, N. Y., Deputy Chairman for the remainder of the year. On December 30, 1938, the Board of Governors of the Federal Reserve System redesignated Owen D. Young Chairman and Federal Reserve Agent of this bank for the year 1939. On the same date, the Board of Governors of the Federal Reserve System reappointed Beardsley Ruml a Class C director for a term of three years beginning January 1, 1939, and redesignated him Deputy Chairman of the Board of Directors of this bank for the year 1939.

In April, 1938, the Board of Governors of the Federal Reserve System appointed Marion B. Folsom, Treasurer, Eastman Kodak Company, Rochester, N. Y., a director of the Buffalo Branch, for the unexpired portion of the term ending December 31, 1938. In December, the Board of Governors of the Federal Reserve System reappointed Mr. Folsom a director of the Buffalo Branch for a term of three years beginning January 1, 1939.

In January, 1939, the directors of this bank reappointed Frank F. Henry, Chairman, Washburn Crosby Company, Inc., Buffalo, N. Y., a director of the Buffalo Branch for a term of three years beginning January 1, 1939.

Member of Federal Advisory Council

The Board of Directors of this bank appointed Leon Fraser, President, The First National Bank of the City of New York, New York, N. Y., a member of the Federal Advisory Council for the Second Federal Reserve District, to serve for the year 1939.

Changes in Officers

On January 6, 1938, the directors of this bank appointed Norman P. Davis, formerly Special Assistant, Division of Security Loans, as Manager of the Security Loans Department. Horace L. Sanford, formerly Chief of the Reports Division, Research Department, and Assistant Secretary, was appointed Manager of the Research Department and continued as Assistant Secretary. Insley B. Smith, Special Representative, Bank Relations Department, was appointed Manager of the Bank Relations Department.

The Board of Directors of this bank appointed Harold A. Bilby, formerly Chief in the Auditing Division, Auditing Department, Assistant General Auditor, effective July 1, 1938.

On September 13, 1938, W. Randolph Burgess, Vice President, and Manager of the System Open Market Account, who had been with this bank since December 1, 1920, resigned to accept the position of Vice Chairman of The National City Bank of New York.

On September 22, 1938, Allan Sproul, First Vice President of this bank, was appointed Manager of the System Open Market Account.

The following deaths among officers of this bank occurred during 1938: Jacques A. Mitchell, Manager of the Credit Department, who had been with the bank since March 1, 1927, died March 22, 1938; Charles H. Coe, Vice President, a member of the bank's staff since July 24, 1916, died May 7, 1938; and I. Ward Waters, Manager of the Cash Custody Department, a member of the staff since December 26, 1914, died June 30, 1938.

Directors and Officers

DIRECTORS

Class	Group		Term Expires Dec. 31
A	1	WILLIAM C. POTTER, Old Westbury, N. Y. Chairman, Board of Directors, Guaranty Trust Company of New York, New York, N. Y.	1940
A	2	OTIS A. THOMPSON, Norwich, N. Y. President, The National Bank and Trust Company of Norwich.	1941
A	3	WILLIAM F. PLOCH, Long Beach, N. Y. President, The National City Bank of Long Beach.	1939
B	1	THOMAS J. WATSON, Lebanon, N. J. President, International Business Machines Corporation, New York, N. Y.	1940
B	2	WALTER C. TEAGLE, Port Chester, N. Y. Chairman, Board of Directors, Standard Oil Company (New Jersey), New York, N. Y.	1941
B	3	ROBERT T. STEVENS, Plainfield, N. J. President, J. P. Stevens & Co., Inc., New York, N. Y.	1939
C		OWEN D. YOUNG, Van Hornesville, N. Y., *Chairman* Chairman, Board of Directors, General Electric Company, New York, N. Y.	1940
C		BEARDSLEY RUML, New York, N. Y., *Deputy Chairman* Treasurer, R. H. Macy & Co., Inc., New York, N. Y.	1941
C		EDMUND E. DAY, Ithaca, N. Y. President, Cornell University.	1939

DIRECTORS—BUFFALO BRANCH

	Term Expires Dec. 31
GILBERT PROLE, Batavia, N. Y. Genesee Farm Supply Company.	1939
HOWARD KELLOGG, Buffalo, N. Y. President, Spencer Kellogg and Sons, Inc.	1940
MARION B. FOLSOM, Rochester, N. Y. Treasurer, Eastman Kodak Company.	1941
FRED J. COE, Niagara Falls, N. Y. President, Power City Trust Company.	1939
WILLIAM A. DUSENBURY, Olean, N. Y. President, The First National Bank of Olean.	1940
FRANK F. HENRY, Buffalo, N. Y. Chairman, Washburn Crosby Company, Inc.	1941
ROBERT M. O'HARA, *Managing Director*	1939

MEMBER OF FEDERAL ADVISORY COUNCIL

LEON FRASER

President, The First National Bank of the City of New York, New York, N. Y.

OFFICERS

George L. Harrison, *President*

Allan Sproul, *First Vice President*

Ray M. Gidney, *Vice President*

L. Werner Knoke, *Vice President*

Walter S. Logan, *Vice President and General Counsel*

Leslie R. Rounds, *Vice President*

John H. Williams, *Vice President*

William H. Dillistin, *Assistant Vice President*

J. Wilson Jones, *Assistant Vice President*

Herbert H. Kimball, *Assistant Vice President and Secretary*

John W. McKeon, *Assistant Vice President*

Walter B. Matteson, *Assistant Vice President*

Arthur Phelan, *Assistant Vice President*

James M. Rice, *Assistant Vice President*

Harold V. Roelse, *Assistant Vice President*

Valentine Willis, *Assistant Vice President*

Dudley H. Barrows, *Manager, Personnel Department*

Wesley W. Burt, *Manager, Accounting Department*

Donald J. Cameron, *Manager, Foreign Department*

Felix T. Davis, *Assistant Counsel*

Norman P. Davis, *Manager, Security Loans Department*

Edward O. Douglas, *Manager, Bill Department and Manager, Collection Department*

Edwin C. French, *Manager, Cash Department*

Myles C. McCahill, *Manager, Service Department*

Robert F. McMurray, *Manager, Safekeeping Department*

Silas A. Miller, *Manager, Securities Department*

Horace L. Sanford, *Manager, Research Department, and Assistant Secretary*

William A. Scott, *Manager, Government Bond Department*

William F. Sheehan, *Manager, Bank Examinations Department, and Chief Examiner*

Insley B. Smith, *Manager, Bank Relations Department*

Todd G. Tiebout, *Assistant Counsel*

William F. Treiber, *Assistant Counsel*

Rufus J. Trimble, *Assistant Counsel*

Charles N. Van Houten, Jr., *Manager, Security Custody Department*

George W. Ferguson, *General Auditor*

Harold A. Bilby, *Assistant General Auditor*

OFFICERS—BUFFALO BRANCH

Robert M. O'Hara, *Managing Director*

Reginald B. Wiltse, *Assistant Manager*

Halsey W. Snow, *Cashier*