

Twenty-sixth Annual Report
of the
**FEDERAL RESERVE BANK
OF PHILADELPHIA**

1940



Third Federal Reserve District

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FEDERAL RESERVE BANK
OF PHILADELPHIA

May 15, 1941.

*To the Stockholders of the
Federal Reserve Bank of Philadelphia:*

Presented herewith is the twenty-sixth annual report of the Federal Reserve Bank of Philadelphia, containing a summary of the operations of this Bank and a review of business, banking and credit conditions in the Third Federal Reserve District during 1940.

JOHN S. SINCLAIR

President

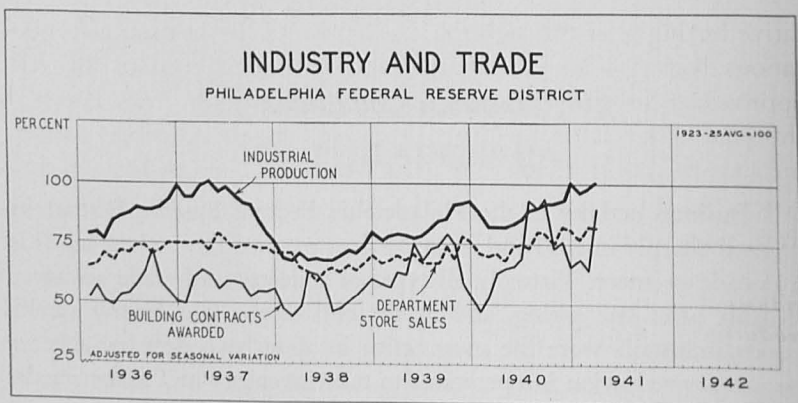
Business Conditions

Business activity in the Philadelphia Federal Reserve District increased sharply in 1940 and in many lines reached the highest levels in a decade or more. Virtually all types of industry and trade advanced steadily after late spring, and by the end of the year several capital goods industries were the most active in about two decades. After a temporary reduction in operations to take inventory and make repairs in January, the gains were extended into 1941, with further substantial expansion in prospect.

Orders for steel, textiles, and other defense materials continued to exceed output and shipments in the first quarter of 1941, despite unusually active production. With backlogs in key industries accumulating, manufacturing facilities expanding, and government and private expenditures increasing, the volume of business in 1941 is expected to be the largest since the peaks reached during the last World War.

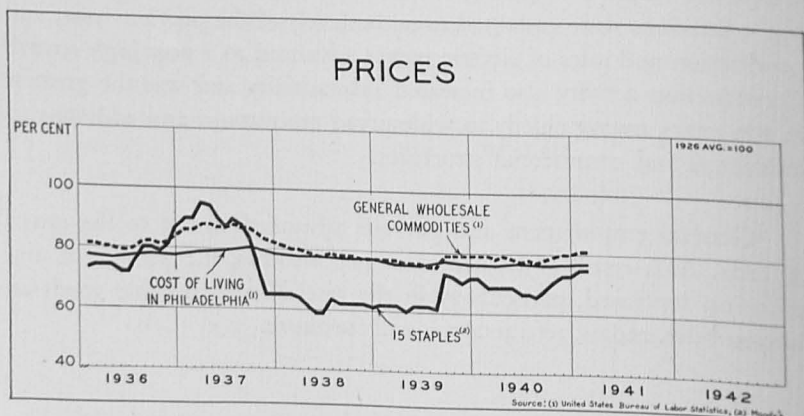
Manufacturing activity increased considerably from 1939 to 1940, when the output of capital goods was the largest in eleven years. Mining operations were sustained near the levels of the previous year, and production and sales of electric power advanced to a new high record. Construction activity also increased substantially and was the greatest in ten years, owing chiefly to widespread renovations and additions to industrial and commercial structures.

General employment and payrolls advanced almost to the peaks of 1937. As a result of higher consumer incomes, the volume of distribution increased, particularly in the case of such durable goods as automobiles, radios, refrigerators, and furniture.



Less accumulation of inventories was in evidence in 1940 than in the previous active year of 1937. Industry generally appears to have allocated deliveries on the basis of actual or average requirements to minimize speculative buying. In some cases, stocks were bought well ahead as a protection against possible future shortages, but for the most part the accumulation of inventories reflected requirements for higher operating schedules and more active sales. The largest increases were in supplies of raw materials.

Commodity prices generally declined in the late fall of 1939 and in early 1940 from the unusually high levels reached in a surge of specu-



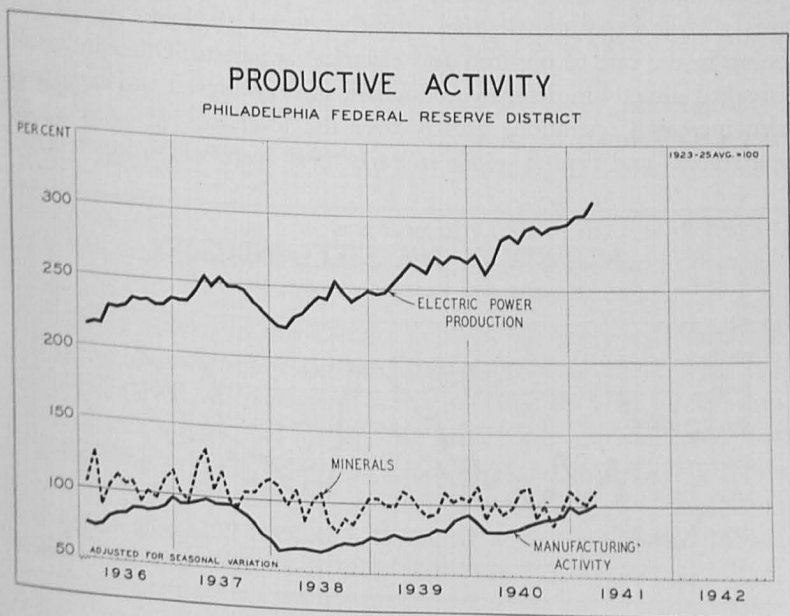
lative buying after the outbreak of war abroad. By late summer, quotations began to advance sharply and toward the end of the year approached and in some cases exceeded the peaks in 1939. Potential shortages of key labor, materials, plants, and shipping facilities contributed to strength in commodity markets early in 1941 as the industrial system sought to make full use of all available facilities in the shift from peacetime to defense production.

Industrial production

Industrial activity improved steadily in 1940, after some decline in the first quarter of the year from the high levels reached in the latter part of 1939. By December 1940 in-

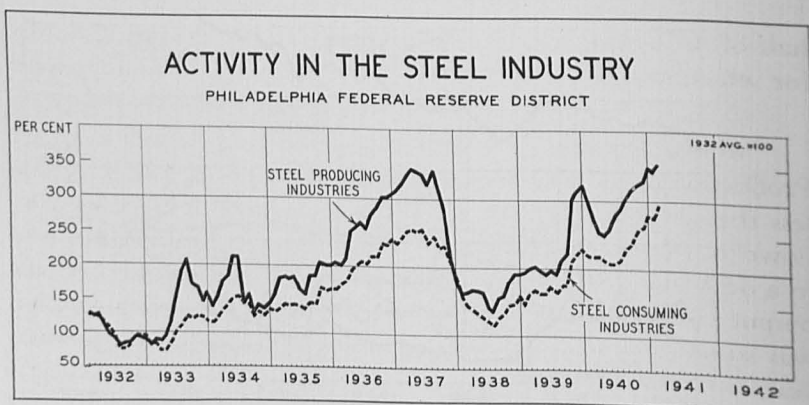
dustrial production in general approximated the recovery peaks attained in the spring of 1937 and was 8 per cent above the level prevailing at the end of 1939. Operations advanced further in the first quarter of 1941, and continued expansion is in prospect for the balance of the year.

Manufacturing activity increased more than 20 per cent between



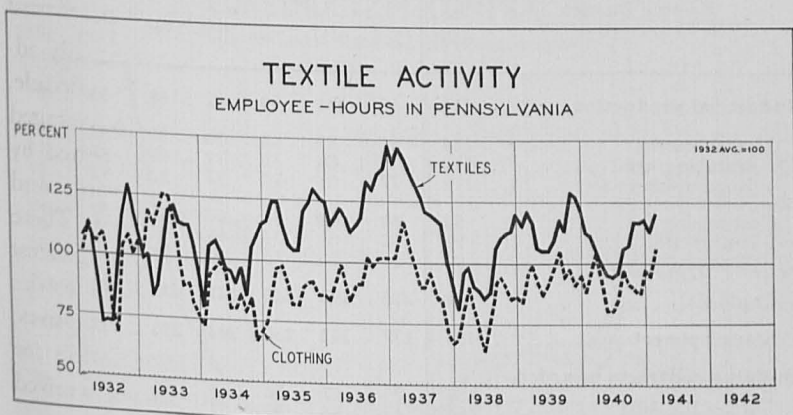


the low point in March 1940 and December, when, on a seasonally adjusted basis, operations were at the highest point in more than a decade. The largest gains were in the output of heavy goods, which averaged 28 per cent above 1939. Particularly sharp increases were reported by the transportation equipment industry, especially at shipyards and plants manufacturing locomotives, cars, and allied products. There was a large expansion in the output of metal products, the greatest being in the case of pig iron and electrical apparatus. Other industries engaged directly in defense production, such as aircraft and explosives, also increased operations greatly over the levels of 1939. Orders for armaments and capital goods in early 1941 were still being received



from our government and from England faster than the goods could be produced and shipped.

The output of consumers' goods in general showed little change throughout the year and averaged about 5 per cent below 1939. The principal declines were in the output of shoes and certain textile products, especially carpets and rugs, hosiery, and silk goods. Production in most other lines was well sustained at levels slightly above those prevailing a year earlier. New orders accumulated rapidly in late 1940 and early 1941, providing backlogs against which operations could be maintained at high levels throughout the greater part of the first



half of the current year. This was especially true in the case of textiles, for which large government orders were received and are in prospect.

Mining activity in this District in 1940 was fairly well sustained. Production of anthracite exceeded 50,000,000 tons, or about 3 per cent less than in 1939 when demand was stimulated by a six-weeks' shut-down of bituminous coal mines. The market for anthracite has been in a declining trend, however, for some years, and, except for 1938, the output last year was the smallest since 1933. In early 1941 production was sustained around the levels prevailing at the end of the previous year.

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The output of bituminous coal in this District in 1940 amounted to 113,000,000 tons, was 22 per cent above the low level of 1939, and was the largest since 1930. Production continued high in the early months of 1941, reflecting in part some accumulation of inventories against the possibility of curtailed operations at the expiration of the wage contract on April 1. Exports of coal from the United States, chiefly to Canada, increased sharply in the year, aggregating 17,000,000 tons as against less than 13,000,000 in 1939.

Productive activity Philadelphia Federal Reserve District (1923-25 average = 100)	Annual averages of monthly indexes						Monthly	
	1929	1932	1937	1938	1939	1940	Dec. 1939	Dec. 1940
Industrial production.....	110	63	91	70	82	88	93	101
Manufacturing.....	111	61	89	68	80	87	93	100
Durable goods.....	110	39	88	55	72	93	95	115
Nondurable goods.....	112	77	91	77	87	82	92	89
Coal mining.....	92	60	65	56	63	64	57	69
Anthracite.....	91	62	64	57	63	62	55	67
Bituminous.....	98	51	76	53	64	78	77	82
Crude oil.....	230	295	498	445	437	424	479	445
Electric power output.....	191	177	242	238	263	285	269	295
Building contracts awarded								
Total.....	132	34	57	54	65	73	53*	66*
Residential.....	104	17	38	35	57	57	52*	64*
Nonresidential.....	160	41	71	66	50	72	45*	76*
Public works and utilities...	146	66	84	87	124	120	85*	73*

* Three-month moving average.

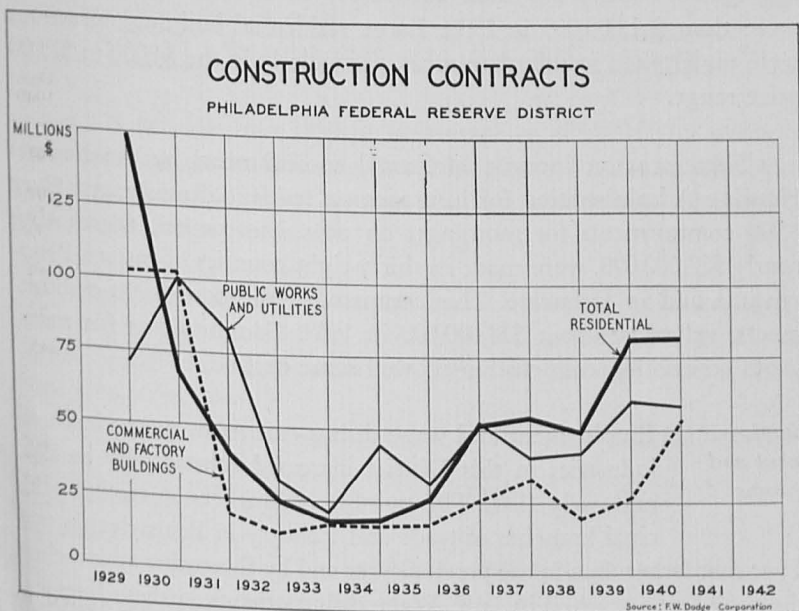
The production of crude oil in the Bradford Field amounted to about 14,250,000 barrels in 1940, or 3 per cent less than in the previous year. This volume was the smallest since 1935 and reflected to a large extent the loss of export markets. Shipments of oil from this country were reduced to about 29,500,000 barrels as compared with nearly 46,000,000 barrels in the previous year.

Output of electric power by eight reporting systems, representing over 90 per cent of the total production in this District, reached a record

high of 8,850,000,000 kwh., or 8 per cent more than in 1939. Production continued active in early 1941. Total sales of electric power in 1940 increased 9 per cent over the previous year, and sales to industry increased 10 per cent to approximately 4,275,000,000 kwh.

**Con-
struction**

The volume of construction in this District during 1940 expanded substantially from 1939 to the highest levels in the past ten years. The value of total awards of building contracts reached \$221,500,000, or 12 per cent more than a year earlier.



The volume of residential building expanded slightly from the ten-year peak reached in 1939, but the principal gain was in factory and commercial building. Further increases are in prospect during 1941, as additional plant expansions and the erection of new plants are under way, requirements for defense housing in industrial areas have increased, and generally higher consumer incomes and more active business are expected to sustain residential and commercial building.

Awards for factories and commercial structures aggregated \$53,700,000 in 1940, or about double the value of the year before. New aircraft factories and powder plants are being erected, and shipyards, steel mills, and plants manufacturing machinery and other metal products are being expanded and rehabilitated. Many new commercial buildings are being erected in Philadelphia and several other large cities, and existing structures are being extensively reconditioned.

The value of contracts awarded for the erection of family houses aggregated slightly less than \$61,000,000 in 1940 as against slightly more than \$61,000,000 in 1939. Large residential building operations were undertaken in suburban areas, particularly in the \$4,000 to \$7,000 price range.

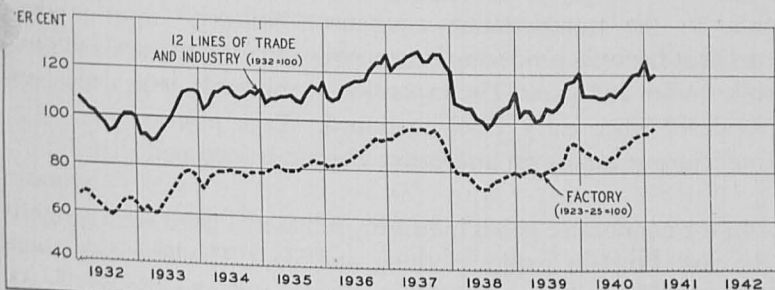
There was an increase in formal commitments by the Federal Housing Administration for insurance on residential mortgages. Over 4,900 commitments for mortgages on new construction, aggregating nearly \$22,000,000, were made in thirty-eight counties of eastern Pennsylvania and in Delaware. This compared with about 3,900 commitments, valued at about \$18,000,000 in 1939. Commitments for mortgages on existing construction showed some decline.

Employment and income

Employment and wage disbursements in nonagricultural industries in this District increased substantially in 1940 and early 1941. The number of workers in twelve principal branches of trade and industry in Pennsylvania was 6 per cent larger than in the previous year and by December approached the peak levels reached in 1937. Wage disbursements in these lines expanded by 13 per cent from 1939 and in December were the largest in more than a decade. The principal gains were in bituminous coal mining, manufacturing, and quarrying.

The number of wage earners in Pennsylvania factories in 1940 averaged over 930,000, or 7 per cent more than in the previous year. This compared with 985,000 in 1937. At the year's high in December, more than a million workers were employed. Wage payments in

EMPLOYMENT IN PENNSYLVANIA



creased 16 per cent over 1939 to an average of \$23,500,000 a week, or about the same as in 1937. By December, factory wage earners were receiving about \$27,500,000 a week, and this volume was expanded to over \$30,000,000 in April 1941.

Wage payments in the durable goods industries increased 28 per cent to the highest level on record, while in industries producing lighter goods disbursements were 1 per cent smaller than in 1939.

Indexes of general employment and payrolls—Pennsylvania (1932 avg. = 100; indexes are annual averages.)	Relative importance—% of total	Employment				Payrolls			
		1937	1938	1939	1940	1937	1938	1939	1940
General index*	100.0	125	105	108	114	172	129	146	165
Manufacturing.....	48.9	147	120	130	139	217	152	185	214
Anthracite.....	6.9	81	70	67	67	81	66	67	66
Bituminous coal.....	5.7	123	102	89	106	217	158	167	207
Quarrying.....	0.6	119	94	101	109	228	154	186	209
Crude petroleum.....	0.2	161	145	132	134	171	164	155	161
Public utilities.....	4.4	96	95	94	98	104	103	105	110
Retail trade.....	15.8	119	107	106	110	130	122	123	130
Wholesale trade.....	4.7	118	113	116	120	119	114	119	126
Hotels.....	1.1	112	110	106	102	123	123	119	120
Laundries.....	0.7	105	100	98	104	119	121	125	133
Dyeing and cleaning..	0.2	105	104	96	100	120	126	117	125

* Includes building and construction.

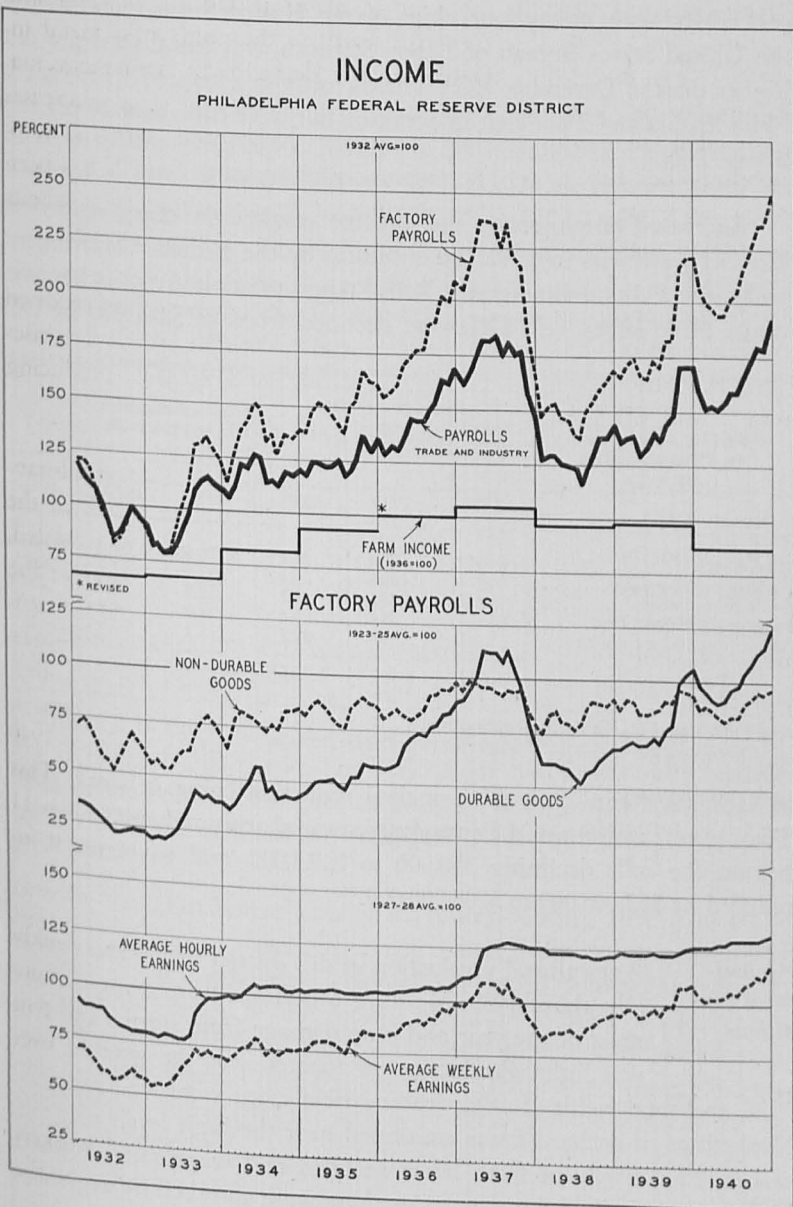
Large gains occurred in the year at plants producing primary and finished iron and steel products. Activity in the nonferrous metal industries was sharply stimulated by the demand for armament materials. In the transportation equipment industry, large increases occurred at factories producing locomotives and cars, aircraft, and automobile bodies and parts. The expansion at shipyards, which has been in evidence since early 1936, continued. Wage payments at plants manufacturing explosives and heavy chemicals increased sharply.

In the nondurable goods industries, substantial gains were reported in the case of certain textiles, clothing, and foods. The largest decreases were at textile dyeing and finishing plants, and at mills producing hosiery and silk goods.

Hourly and weekly earnings of factory workers advanced substantially in 1940, owing largely to an increase in overtime work in the capital goods industries, where the supply of labor is relatively limited, and to increases in basic wage rates. Average hourly earnings in the year rose 4 per cent from the previous record in 1939 to 72 cents, reaching a peak of nearly 78 cents in April 1941. The highest earnings, averaging over 80 cents an hour, were in the printing, iron and steel, and transportation equipment industries. Working time in Pennsylvania factories increased to an average of 37.6 hours a week in 1940 and reached a peak of slightly more than 40 hours in December. This level was somewhat below that prevailing in 1937 and more than 11 hours a week less than in 1929. The longest hours and the largest increases from 1939 occurred in the capital goods industries.

Reflecting the increase in wage rates and working time, weekly earnings of factory workers in 1940 advanced to an average of more than \$27.00, the highest for any year since the last war and 8 per cent more than in 1939. At the peak in December, earnings averaged over \$29.50 a week.

The cost of living for wage earners and lower-salaried workers showed little change during 1940. By March 1941 the index of the



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cost of living in thirty-four cities of the United States, published by the United States Bureau of Labor Statistics, was less than 2 per cent higher than in December 1939. These costs also advanced 1 per cent in Philadelphia and 2 per cent in Scranton but were still about 20 per cent below 1929.

Increased employment and income resulted in sharp reductions in relief payments in 1940. Expenditures by the Federal Government, under the Federal Emergency Relief Appropriation Acts, in Pennsylvania, New Jersey, and Delaware declined from \$313,000,000 in 1939

Public assistance in Pennsylvania by type	Average number of persons (in thousands)			Amount spent (in millions)		
	1938	1939	1940	1938	1939	1940
Direct relief.....	642	744	503	\$ 76.0	\$ 91.6	\$ 60.9
Federal work relief.....	897	694	532	169.5	132.7	100.4
Old-age assistance.....	91	83	97	23.5	20.3	25.3
Pensions for the blind.....	11	12	13	4.2	4.4	4.7
Aid to dependent children..	61	93	129	7.2	10.9	16.7
Total.....	1,672*	1,564*	1,214*	\$280.4	\$259.9	\$208.0

* Adjusted to eliminate duplication.

Source: Pennsylvania Department of Public Assistance.

to \$189,000,000 in 1940, the principal reduction being in work relief. Total public assistance in Pennsylvania was sharply reduced, the number on the rolls declining 350,000 to 1,214,000, and payments being reduced by \$52,000,000 to \$208,000,000.

Agricultural conditions

Agricultural production in this district in 1940 was generally above 1939. Moisture conditions were favorable over most of the year and crop damage from storms and frost was light. Production of tobacco was the greatest since 1931, and total yields of other leading field crops were well sustained. Marketings of orchard fruits continued near the high levels of a year earlier. The supply of farm labor declined and wage rates advanced in the second half of the year, as workers were absorbed by expanding

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industry. Farm prices were generally firm at levels somewhat above the average in 1939.

Farm cash income in Pennsylvania, New Jersey, and Delaware increased from \$386,000,000 in 1939 to \$404,000,000 in 1940. This represented a gain of \$10,000,000 to \$137,000,000 in receipts from the sale of crops and an increase of \$8,000,000 to \$259,000,000 in proceeds from the sale of livestock products. Government payments to farmers reached a new high level of about \$8,400,000 compared with \$8,200,000 in 1939 and only \$4,000,000 in 1938. The average income for each farm

Farm cash income— Penna., New Jersey, Delaware (In millions of dollars)	Crops	Livestock products	Government rental and benefit payments	Total
1936.....	\$137.8	\$248.6	\$3.0	\$389.4
1937.....	141.0	269.2	3.2	413.4
1938.....	117.7	256.2	4.0	377.9
1939.....	126.9	251.0	8.2	386.1
1940.....	136.8	258.8	8.4	404.0

Source: United States Department of Agriculture.

in the State of New Jersey was \$4,100, which next to California was the highest in the United States. In Delaware, receipts averaged \$2,165, and in Pennsylvania \$1,650. The outlook for 1941 is generally regarded as favorable because of higher earnings of industrial workers and the greater domestic demand for high quality food products.

*Distribu-
tion*

Distributive activity in general during 1940 reached the highest levels in several years. Stocks of goods in retail and wholesale channels increased somewhat but were not large in relation to the volume of business. Sales of durable consumers' goods were especially active, and high quality merchandise was in better demand than has been the case for some time. Christmas trade in this district was the best since 1929, and the outlook for sales in 1941 is favorable.

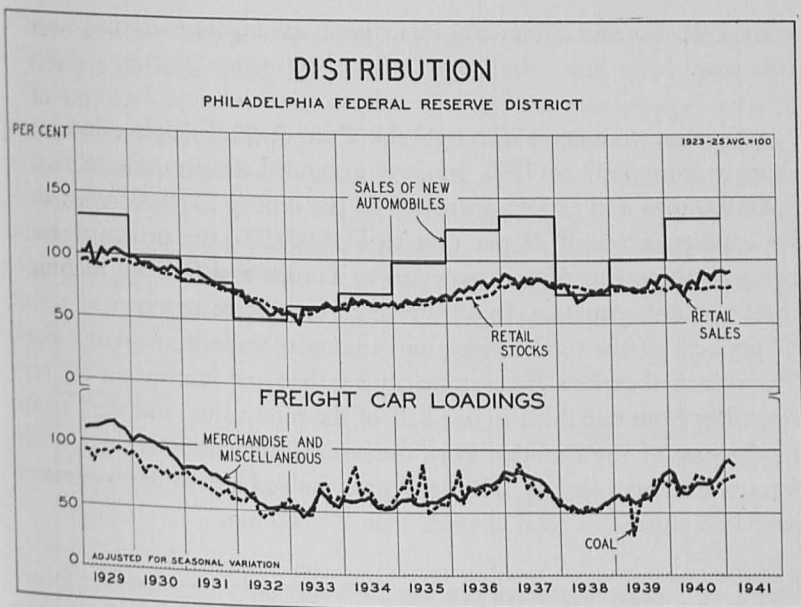
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Sales by department stores in this district increased 7 per cent over the year before and were the largest since 1931. Sales of men's apparel expanded 5 per cent to the greatest volume since 1930. The volume of business at credit stores handling durable consumers' goods advanced only 4 per cent over 1939, when trading in these lines was unusually active, but exceeded any year since 1928. At shoe stores and women's specialty shops, trade in 1940 was about the same as a year before. Inventories in December showed increases over December 1939, ranging from 2 per cent at shoe stores to 8 per cent at department stores.

Distribution Philadelphia Federal Reserve District (1923-25 average = 100)	Annual averages of monthly indexes						Monthly	
	1929	1933	1937	1938	1939	1940	Dec. 1939	Dec. 1940
Retail trade								
Sales.....	100	59	83	75	81	84	88*	92*
Stocks.....	94	59	83	78	77	78	76*	79*
New passenger automobiles...	131	62	136	73	101	134	122	171
Commercial hotels (1934 = 100)								
Occupancy.....	...	86	123	117	114	119	103	105
Income—total.....	...	82	129	122	119	130	134	134
Freight-car loadings								
Allegheny District—total....	106	55	74	54	66	74	84*	90*
Merchandise & miscellaneous	112	56	74	55	66	74	84*	90*
Coal.....	92	58	71	55	64	73	71*	76*
Philadelphia industrial area...	107	62	70	61	62	66	72*	79*
Port of Philadelphia								
Exports (1935-37 = 100).....	170	66	127	121	127	157	177	121
Imports (1935-37 = 100).....	156	58	122	69	84	87	85	80

* Adjusted for seasonal variation.

Wholesale trade sales expanded by 7 per cent in 1940. Buyers for retail stores continued cautious, and a large volume of fill-in orders came into the wholesale markets throughout 1940. Toward the end of the year advance buying of seasonal merchandise expanded substantially. The demand for luxury and semiluxury goods at wholesale was especially strong. Sales of jewelry increased 20 per cent in the year, electrical supplies 18 per cent, and hardware 16 per cent. Such staples as dry goods and groceries were sold in about the same volume as in 1939. Inventories at wholesale establishments at the end of the year were only 4 per cent larger than in December 1939.



Registrations of new passenger automobiles in 1940 aggregated nearly 215,000, or 33 per cent more than in 1939 and nearly as many as the 218,000 registered in 1937. With this one exception, sales in 1940 were the largest on record. Markets for used cars were also active. Although sales continued at unusually high levels, dealers' stocks were increased in early 1941, in anticipation of a possible shortage later in the year when defense activity might absorb materials, labor, and plant facilities in the industry.

Freight-car loadings in the Allegheny District in 1940 totaled over 7,700,000 cars, the largest volume since 1930 and 13 per cent more than in 1939. Gains in the year, amounting to more than 40 per cent, occurred in loadings of coke and ore, owing to the active demand for these materials by the steel industry. Shipments of less-than-carlot freight were the same as in 1939, but the movement of miscellaneous goods increased 16 per cent and coal 14 per cent in the year. The only decrease was in shipments of grain products. The movement of freight originating in Philadelphia showed sharp gains in the fall and continued high in

early 1941. Further substantial increases in car loadings are in prospect this year.

Foreign commerce through the Port of Philadelphia increased sharply from 1939 to 1940. Imports expanded 23 per cent to nearly 5,900,000 tons and exports increased 38 per cent to 2,280,000 tons. Dollar exports increased 24 per cent to \$115,000,000, the principal gains being in shipments of war materials to Europe and finished manufactures to Latin America. In 1939 foreign commerce represented about 17 per cent of the total foreign and coastwise trade through the Port. The principal exports are customarily gasoline and lubricating oil, representing from one-third to one-half of the total value, and steel scrap. In the case of the Camden Port, domestic shipments increased while foreign declined slightly. The aggregate showed a gain of 10 per cent over 1939 to reach a total of more than 275,000 tons.

*Com-
modity
prices*

Prices generally in late 1939 and early 1940 receded somewhat from the peaks reached in September and October after war was declared. But for the year 1940 as a whole quotations averaged above the level of 1939 and in December were generally higher than a year earlier. In early 1941, commodity prices continued to show a marked upward trend.

The principal influences upon price movements have been the large volume of available funds; the potential shortages of certain basic materials, skilled labor, and shipping space; rising costs of production; and active private and government demand. The advance in quotations has been restrained, however, by formal and voluntary priorities and allocations and by a firm attitude on the part of both government and business against speculation and profiteering.

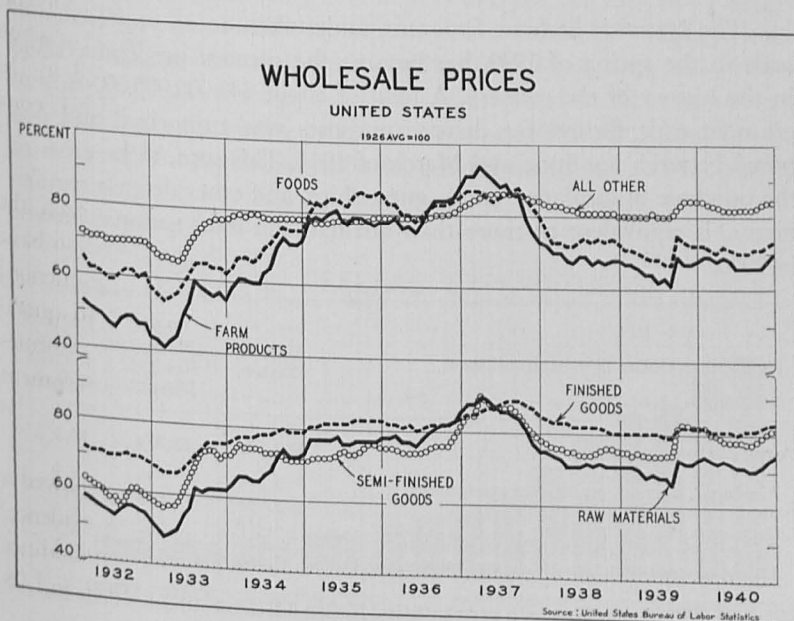
In the first part of 1940, quotations on industrial staples showed a declining tendency, but by autumn sharp increases were in evidence. The average price of a selected group of basic industrial commodities in December was 2 per cent higher than in December 1939 and 28

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per cent above the prewar level in August 1939. The largest increases last fall were in steel scrap, copper, lead, hides, and wool.

Commodity prices (1926 average = 100)	Annual averages of monthly indexes						Monthly	
	1929	1932	1937	1938	1939	1940	Dec. 1939	Dec. 1940
All commodities*	95	65	86	79	77	79	79	80
Raw materials.....	98	55	85	72	70	72	73	74
Semifinished articles.....	94	59	85	75	77	82	71	79
Finished goods.....	95	70	87	82	80	82	82	83
Farm products.....	105	48	86	69	65	68	70	68
Foods.....	100	61	86	74	70	72	73	71
Other commodities.....	92	70	85	82	81	83	84	84
Staple commodities****.....	..	39	84	62	65	69	72	74
Agricultural.....	..	..	71	52	52	54	56	55
Industrial.....	..	..	88	65	76	83	88	90

* United States Bureau of Labor Statistics index of wholesale prices of 813 commodities. **Total—Moody's index of prices of 15 staple commodities.



Prices of agricultural staples also declined until the late summer of 1940, but subsequently advanced. In December, the average quotation on a selected group of these commodities was 3 per cent below a year ago and 13 per cent above the prewar level in August 1939. The principal strength during the advance was in cocoa, coffee, cotton, and wheat.

The general level of wholesale prices declined until September of 1940 and then advanced considerably. The greatest strength was in quotations on farm products. In December the index of 813 commodity prices, compiled by the United States Bureau of Labor Statistics, was 1 per cent higher than in December 1939 and 7 per cent above August 1939.

Banking and National Defense

The National Defense Program, undertaken on an unprecedented scale in the spring of 1940, has become the greatest productive effort in the history of the country. A total of about \$40,000,000,000 in government expenditures for defense purposes was authorized and proposed between last June and March of 1941. This sum, to be used for the purchase of airplanes, tanks, guns, ships, and other defense requirements, is equivalent to more than one-half the total national income in 1940.

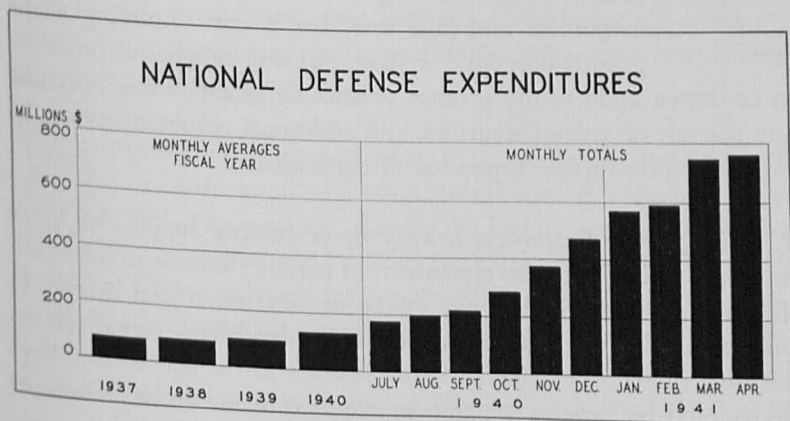
(Dollar figures in millions)	United States	Third Federal Reserve District	Per cent Third District of U. S.
Total major awards.....	\$12,576	\$1,374	10.9%
Airplanes, engines, parts and equipment.....	2,275	29	1.3
Ship construction and equipment.....	5,065	878	17.3
Ordnance and ammunition.....	2,028	180	8.9
Construction other than ship construction.....	1,727	74	4.3
All other equipment, supplies, and material.....	1,481	212	14.3

Source: Bureau of Research and Statistics, National Defense Advisory Commission.

Major defense contracts awarded by the War and Navy Departments from June 1, 1940 to January 31, 1941 approximated \$12,600,000,000, of which nearly \$1,400,000,000 was awarded in the Third Federal Reserve District. Distribution of these contracts among the various phases of the program is indicated in the preceding table.

The problem of accomplishing the objective of national defense is two-fold. First, it is necessary to convert our industrial structure from a peacetime to a defense basis, directing our resources of man power, materials, and money principally toward the production of armaments rather than nondefense products. Second, an effective means must be provided to finance the mobilization and conversion of our resources in such a way as to complete the program as quickly as possible, to spread the burden of cost equitably, and to anticipate problems of post-emergency readjustment.

Particularly important from both the industrial and the financial standpoint is the channeling of resources into the defense effort. Actual government expenditures for defense have advanced steadily from \$153,000,000 last June to about \$760,000,000 in April 1941, and further substantial increases are in prospect as additional facilities come into operation and engineering problems are solved. The result thus far has been not only a rapid expansion in general industrial activity and in



incomes of wage earners but also an unprecedented demand for key materials, skilled labor, plants, and equipment.

New sources of raw materials have been found, and reserves have been accumulated. Jobs have been revised to permit the use of lower skills, and widespread training programs have been undertaken. Plants customarily used for peacetime purposes have been adapted to defense production, old factories have been renovated, and new plants have been erected. In cases where industrial capacity has been inadequate to supply the immediate requirements of the defense program and the market for consumers' or other nondefense goods, systems of priorities have been established either voluntarily, by allocation of orders within industry, or officially, through the Priorities Division of the Office of Production Management.

These methods of making the fullest possible use of our resources are to be supplemented by appropriate financial policies. In addition to avoiding possible shortages and disturbances in individual lines of activity, comprehensive policies affecting all phases of the problem are necessary in a period of national emergency.

***Financing
defense***

The broad objective of financial policy under the national defense program is to provide adequate funds as quickly as possible and in a way that is least disturbing to the general economic welfare. Existing supplies of funds are to be drawn upon to the greatest practicable extent through taxation and the sale of savings securities, and additional requirements will be met through a further expansion of bank credit.

The policy of drawing heavily upon existing supplies of funds arises primarily from two aims: first, to permit everyone to contribute directly and in a tangible way to the national effort and, second, to minimize inflationary developments during the defense period and the probable subsequent deflation. Bank reserves at the end of 1940 were nearly twice as large as the amount required to sustain the volume of

credit then outstanding, and surplus funds were so great as to be beyond the scope of existing monetary and credit powers. The danger in financing national defense through bank credit alone lay in these unwieldy excess reserves and in the possibility that the volume and use of credit in this country might expand far beyond the needs of trade and industry and result in a rising spiral of prices. Under such conditions, attempts at price stabilization without influence over the supply of funds might prove inadequate. But by financing a large proportion of defense expenditures through existing funds rather than through an expansion of bank credit, the possibility of a costly and disruptive advance in prices should be lessened. This policy also has the effect of conserving consumer demand during the emergency, so that productive facilities may be used principally for defense and so that markets in the post-defense period may be better sustained.

It is desirable to finance as much of the defense expenditures as possible out of current income, rather than through borrowing. While revenues may rise as a result of expanding national income, consideration is being given to the possibility of a comprehensive revision of existing tax rates. An appropriate tax program, based upon wide distribution of the burden of cost and apportioned according to income and ability to pay, has the effect of providing additional revenue and of restricting buying power available for the purchase of nondefense goods. Increased revenues during the period of emergency when incomes are large also minimize the tax load necessary in the post-defense period when incomes may decline.

A part of the fiscal program recently announced by the Secretary of the Treasury is the so-called Savings Bond Program to become effective May 1, 1941. This program calls for the issue of appreciation bonds with ten-year maturities and an average return for this period of 2.9 per cent, appreciation bonds with twelve-year maturities and an average return of 2.53 per cent, and income bonds with twelve-year maturities and a return of 2.5 per cent payable semiannually. Holdings of the ten-year appreciation bonds are limited to individuals in their

own right in the amount of \$5,000, maturity value, issued in any one calendar year. This bond is designed to appeal particularly to individuals of moderate income. Ownership of the other two types of bonds is limited to individuals, associations, partnerships, trustees, or corporations other than commercial banks in the amount of \$50,000, cost price, issued in any one calendar year.

It is believed that through this savings bond program and increased tax revenues a substantial part of the cost of defense can be met. But in order to speed up production, banking funds are temporarily needed, not only by the government but also by private contractors working on government orders. This has represented a considerable financial problem, because the amounts of funds needed in many cases were larger than the general credit standing of some of the smaller and moderate-sized concerns warranted. Under regulations existing until October 1940, no assignment of a claim against the government was valid. This prevented the hypothecation of amounts to become due on government contracts for the purpose of borrowing funds to finance operations against these contracts.

On October 9, this difficulty was overcome by the passage of the "Assignment of Claims Act of 1940," which provided that the restriction on assignments should not apply in case "moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating \$1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal loan agency." In this way it was made possible for banks to lend to manufacturers on the security of claims against the government, and a substantial volume of such loans has been made.

Another difficulty essentially financial in character was the problem of encouraging the erection of new plant facilities for defense production. Plants required during this emergency period could not be expected to be operated at or near capacity when defense production

came to an end. This meant that many establishments cooperating in the defense effort by expanding their facilities would subsequently be burdened with idle capacity.

In order to meet this problem, the "Second Revenue Act of 1940," also passed in October, provided that the cost of facilities erected for defense production might be amortized over a period of five years and that this amortization charge would be deductible from income for tax purposes. To take advantage of this provision, the manufacturer is required to submit two certificates: first, a "Necessity Certificate" from the Advisory Commission to the Council of National Defense and the Army or the Navy certifying that the facilities are essential in the defense effort and, second, either a "Certificate of Nonreimbursement," stating that the government is not paying for the facilities directly or indirectly, or, in case the government pays the cost of erecting the plant, a "Certificate of Government Protection," stating that adequate provision has been made to assure the reversion of title to the government.

Three methods in general have been used to provide adequate productive facilities. The first of these involves construction by the manufacturer using his own funds, government funds, or funds borrowed from banks. In case government funds are used, title to the facilities reverts to the government at the completion of the payment period. After that time the manufacturer may purchase the facilities if he desires. The second method involves construction of facilities by the government to be leased to private manufacturers. The third plan involves the construction of plants to be owned and operated by the government.

In order to facilitate the financing of defense production, including the provision of funds for both supplies and facilities contracts, an organization was established through the Federal Reserve System. Defense Contract Officers were appointed in each of the twelve Federal Reserve Banks and twenty-four branches to cooperate with the Board

of Governors and with the Office of Small Business Activities in Washington. In this Bank, W. J. Davis, Vice President, was appointed. His function is to advise bankers, prime contractors, and subcontractors on financial problems and to assist in spreading the burden of defense production among all available facilities. In cases where credit is warranted but cannot be furnished by local banking institutions, funds for working capital may be made available by the Federal Reserve Bank under the provisions of section 13b of the Federal Reserve Act.

Subcontracting Another immediate problem under the defense program, in addition to financing production, is the use of all available plant and labor facilities through the extension of subcontracting. Trade associations, state agencies, government organizations, and local groups have actively sought to effectuate such an extension of production.

One of the striking developments in this field has been the "York Defense Plan," established by manufacturers and businessmen in York, Pennsylvania. Under this plan, comprehensive surveys of all facilities available for defense production have been made and the equipment has been "pooled" to assure its fullest possible use. Machine tools in the metal-working industries and at plants in other lines are being made available for subcontracting, and complete records are being kept of idle machine and man-hours in all types of plants, so that prime contractors may sublet parts of their work in this area. Prices on subcontracted work are established only after trial runs, so that the subcontractors are assured a reasonable profit. At the same time, overhead and profits are reduced, and prime contractors are given the privilege of reviewing all costs and estimates.

Labor facilities have been expanded through training at plants and in vocational schools. The existing supply is being organized through a complete survey of all skilled machine operators. The object of this survey is to make available for defense production any skilled workman, whatever his present occupation. If additional workers are re-

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quired, arrangements are made with their present employers to provide for their return to their jobs at the completion of their defense work without loss of seniority or other privileges. This has been an important problem throughout the country, as many skilled workers have taken unskilled jobs and are no longer listed as unemployed. The entire York Plan has received widespread attention as a model upon which other communities might be organized.

*The
Defense
Contract
Service*

In order to facilitate subcontracting by the extension of such local plans as that in York and by the coordination of the productive capacities of all plants, large and small, a Defense Contract Service has been established in the Office of Production Management, and regional offices have been organized in each of the Federal Reserve Banks and branches.

Four principal divisions of the service have been established in Washington: the business section, which provides information on where, when, and how to bid on Army and Navy contracts; the financial section, which provides information on all financial matters relating to prime contracts and subcontracts; the subcontracting and engineering section, which provides general information to facilitate subcontracting and offers specific consultation and technical advice in particular cases; and the contract section, which provides information on the terms and provisions of government contracts.

In the Third Federal Reserve District, Thomas S. Gates, President of the University of Pennsylvania, who has had broad experience in industry and investment banking, was appointed District Coordinator early in 1941. Under Mr. Gates, Orville H. Bullitt, an investment banker, was appointed as Deputy Coordinator, and Frederick W. Hankins, Assistant Vice President in charge of operations of the Pennsylvania Railroad, was appointed as District Manager. When completely organized with a staff of qualified experts and engineering consultants, this regional Defense Contract Service will make a comprehensive study of available plant facilities in this district and coordinate pro-

ductive efforts. Contractors are being advised as to the procedure involved in bidding on government contracts and in participating in or sharing work on government orders which are already under way. In particular cases, technical advice is offered as to how contracts may be subdivided and as to what facilities can be adapted to this production.

The significance of such organizations designed to extend subcontracting arises from the necessity for accomplishing the objectives of the National Defense Program as quickly and effectively as possible. To do this it is necessary that all available plants, equipment, and skilled labor be employed, as the erection of new facilities and the training of additional workers requires months of valuable time. Although new plants are required in many key industries, it is further important in this national effort that existing industrial capacity be used to the fullest extent possible, not only to accomplish the program quickly but also to avoid distortions which may accentuate problems of readjustment when the defense period is ended.

Banking and Credit Conditions

Bank Reserves

Reserve funds of the banking system in 1940 expanded to the largest volume on record, in spite of a sustained advance in the amount of money in circulation. The demand for credit and currency was sharply stimulated in the second half of the year by increased industrial and trade activity under the expanding defense program, but the inflow of funds exceeded public and private requirements, so that toward the end of the year surplus reserve balances reached a new high level.

The principal source of reserve funds again in 1940 was the heavy inflow of gold from abroad. The spread of war accentuated the flight

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of capital to this country, and large gold balances were deposited in payment for purchases of war materials. A further source of supply to the money market was the excess of Treasury disbursements over receipts, reflected in substantial reductions of Treasury balances with the Reserve Banks. Credit extended by the Federal Reserve System was reduced in the year, owing to sales of government securities from the System Open Market Account.

In the Third Federal Reserve District, large balances were received through the interdistrict settlements. Treasury payments from balances with the Reserve Bank into accounts of business concerns and individuals continued to exceed receipts. A large volume of defense contracts was awarded to shipyards and munitions plants, and increased funds were supplied to Army and Navy establishments under the defense program. Other government disbursements in the area were reduced, especially payments for work relief.

Bank reserves in 1941 are not expected to show the same large increases as have been in evidence in preceding years, and the volume of excess reserves may even be decreased. The flow of gold to this country has declined substantially in recent months, as reserves in foreign countries, particularly England, have been sharply reduced, and new shipments must arise largely from additional production. Continued expansion in business activity will result in larger demands for currency and credit. Government borrowing to finance the defense program may reach an unprecedented total, and private requirements for working capital will increase as new plants and equipment come into operation, as the use of subcontracting facilities is extended, as prices rise, and as public and private expenditures generally advance further.

*Federal
Reserve
Bank*

Cash reserves of the Federal Reserve Bank of Philadelphia at the end of 1940 were \$1,066,000,000, close to a record level. This volume was \$193,000,000 or 22 per cent larger than in 1939. Continued expansion was in evidence in early 1941.

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Cash reserves of the Federal Reserve Banks (End of year; dollar figures in millions)	Philadelphia		All Federal Reserve Banks	
	1939	1940	1939	1940
Total reserves	\$873.6	\$1,066.4	\$15,524.2	\$20,035.6
Required reserves:				
Against Federal Reserve notes... (40% in gold certificates)	139.6	164.3	1,983.4	2,372.4
Against deposits..... (35% in gold certificates or lawful money)	251.9	286.9	4,529.3	5,644.3
Total required.....	\$391.5	\$451.2	\$6,512.7	\$8,016.7
Excess reserves	\$482.1	\$615.2	\$9,011.5	\$12,018.9
Proportion of total to required...	223%	236%	238%	250%

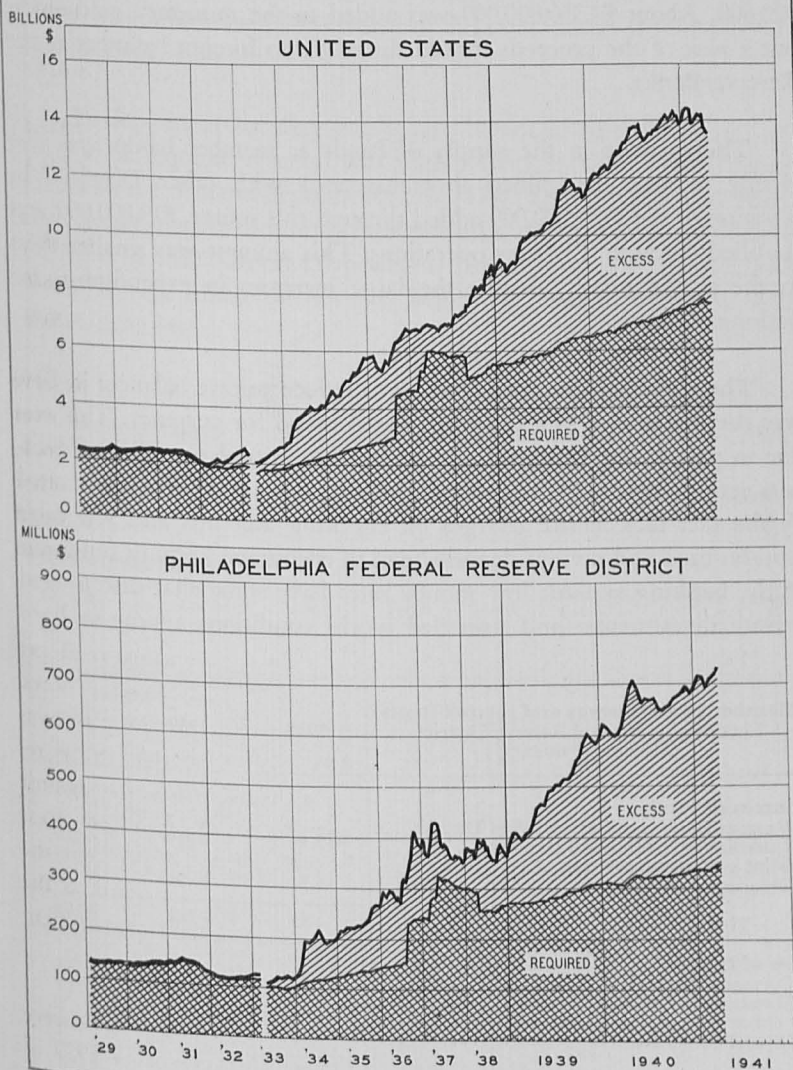
In the country as a whole the reserves of the twelve Federal Reserve Banks showed an increase of 29 per cent from 1939 to a level of over \$20,000,000,000, reflecting the expansion in the monetary gold stock. The gain at this Bank was due to the transfer of balances from other Districts on commercial account, an increase in foreign deposits allotted to the Bank, and proceeds from the sale of securities by the System Open Market Account.

Reserves required to be held by this Bank, amounting to 35 per cent against deposits and 40 per cent against Federal Reserve notes, were substantially heavier in 1940 than in 1939. But this increase was smaller than the expansion in the supply of funds, so that excess reserves advanced sharply to 136 per cent of required reserves as against 123 per cent in 1939. At all Federal Reserve Banks the ratio of excess to required reserves increased to 150 per cent from 138 per cent the year before. Excess cash reserves held by the Philadelphia Bank at the close of the year amounted to \$615,000,000, and in the Reserve System as a whole to more than \$12,000,000,000.

**Member
banks**

Member bank reserves in the Philadelphia Federal Reserve District increased \$105,000,000 from the end of 1939 to \$703,000,000 in December 1940. As in the case of cash re-

MEMBER BANK RESERVES



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serves at the Reserve Bank, this gain was smaller than that in the preceding year. Throughout the country, reserve balances of member banks increased nearly 20 per cent, or \$2,400,000,000, to more than \$14,000,000,000. About \$4,350,000,000 was added to the monetary gold stock, but a part of the proceeds moved directly into foreign balances at the Reserve Banks.

The increase in the supply of funds at member banks was due chiefly to amounts gained in transactions with other Districts. In addition to the \$170,000,000 added through this source, \$19,000,000 was supplied through Treasury operations. This amount was smaller than in the previous year, despite the large increases in expenditures for national defense.

The principal influence tending to reduce reserve balances in 1940 was the increase of \$75,000,000 in the demand for currency. This was due in part to the continued expansion in industrial payrolls and business activity generally. The demand for currency has been accentuated by the fact that service charges on checking accounts and low rates paid on time and savings deposits tend to encourage keeping funds out of the banking system; low money rates have somewhat discouraged private investments; and unsettled world conditions appear to have

Member bank reserves and related items Philadelphia Federal Reserve District (Millions of dollars)	1938	1939	1940
Sources of funds:			
Reserve Bank credit extended in District.....	- 5	+ 2	+ 0
Interdistrict commercial transfers.....	-39	+219	+170
Mint gold purchases, net.....	+ 5	+ 5	+ 4
Treasury operations.....	+74	+ 61	+ 19
Total.....	+35	+287	+193
Uses of funds:			
Currency demand.....	+22	+ 53	+ 75
Member bank reserve deposits.....	+ 9	+224	+113
"Other deposits" at Reserve Bank.....	+ 5	+ 10	+ 5
Other Federal Reserve accounts.....	- 1	- 0
Total.....	+35	+287	+193

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resulted in some hoarding, chiefly on foreign account. Throughout the country, nearly two-fifths of the increase in circulation during 1940 was in denominations of \$50 or more. At the end of the year this type of currency represented 28 per cent of the total money in circulation as against 18 per cent ten years ago.

As deposits at member banks also increased to record levels, the volume of required reserves was higher than in 1939. These requirements on net demand deposits are $22\frac{3}{4}$, $17\frac{1}{2}$, and 12 per cent at central reserve city, reserve city, and country banks, respectively, as established on April 16, 1938. On time deposits the requirement is 5 per cent. These levels average about one-seventh below the maxima allowed under the existing law.

Member banks Phila. Fed. Res. District (Dollar figures in millions)	Reserves with Federal Reserve Bank			Due from domes- tic banks	Per cent of re- quired reserves	
	Held	Re- quired	Excess		Excess reserves	Due from banks
Philadelphia banks						
1939—Jan.: 1st half...	\$243.8	\$174.3	\$ 69.5	\$140.1	40%	80%
1940—Jan.: 1st half...	444.8	210.8	234.0	174.8	111	83
1941—Jan.: 2nd week.	517.2	232.7	284.5	179.3	122	77
Country banks						
Cities with population of 100,000 or more						
1939—Jan.: 1st half...	40.4	23.5	16.9	52.7	72	224
1940—Jan.: 1st half...	40.9	25.0	15.9	83.1	64	332
1941—Jan.: 2nd week.	50.8	27.9	22.9	85.7	82	307
Cities with population of 15,000 to 100,000						
1939—Jan.: 1st half...	47.4	31.6	15.8	35.4	50	112
1940—Jan.: 1st half...	60.2	32.3	27.9	50.6	86	157
1941—Jan.: 2nd week.	68.8	33.0	35.8	61.6	108	187
Cities with population under 15,000						
1939—Jan.: 1st half...	60.3	41.4	18.9	58.0	45	140
1940—Jan.: 1st half...	74.6	40.5	34.1	92.2	84	228
1941—Jan.: 2nd week.	80.3	42.3	38.0	105.2	90	249
All member banks						
1939—Jan.: 1st half...	391.9	270.8	121.1	286.2	45	106
1940—Jan.: 1st half...	620.5	308.6	311.9	400.7	101	130
1941—Jan.: 2nd week.	717.0	335.8	381.2	431.8	114	129

In the first half of January 1941, total reserves at Philadelphia banks were 122 per cent larger than the amounts required to be held against deposits, and at country banks these balances were 95 per cent above requirements. The surpluses are widely distributed among the member banks and are supplemented in most cases by large balances carried with correspondents, especially in the case of country banks. The preceding table shows the distribution of excess reserves among the banks in this district.

In the case of nearly three-fourths of the 651 member banks in this District, reserve balances in the second week of January 1941 were 25 per cent or more in excess of requirements, and in 29 per cent of the banks, reserves were at least double requirements. Of the 171 banks which reported reserves less than 25 per cent in excess of requirements, all but 20 had demand balances with correspondents equal to 50 per cent or more of required reserves.

Condition of Member Banks

Deposits and resources of member banks in this District during 1940 advanced to the largest volumes on record. Outstanding credit expanded moderately further as loans were increased. Credit was extended chiefly to supply the larger working capital requirements of industry resulting from the higher levels of defense production and general business activity; investment holdings declined. Available funds at local banks, however, substantially exceeded the demand for credit, so that the principal change in resources during the year was another large increase in cash assets. These assets expanded 15 per cent and at the end of the year comprised 40 per cent of deposits as against 37 per cent at the end of 1939 and 19 per cent in 1929.

The net earnings from current operations of member banks were increased slightly in 1940. Recoveries and profits on sales, however, were reduced and charge-offs continued heavy, so that net profits for the year were somewhat smaller than in 1939.

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Member banks Philadelphia Federal Reserve District (Millions of dollars)	December 31, 1940	Changes in—	
		1939	1940
RESOURCES			
Loans.....	1,020	+ 40	+ 74
Investments.....	1,379	— 25	— 17
Cash assets.....	1,383	+365	+180
Real estate assets.....	152	— 9	— 20
Other.....	22	+ 2	— 7
Total.....	3,956	+373	+210
LIABILITIES AND CAPITAL ACCOUNTS			
Deposits.....	3,452	+371	+221
Other liabilities.....	22	— 1	— 3
Capital accounts.....	482	+ 3	— 8
Total.....	3,956	+373	+210

Deposits The volume of deposits at member banks in this District increased \$220,700,000 during 1940 to an all-time peak of over \$3,450,000,000, continuing the strong upward trend which began in the spring of 1938. By the end of the year, deposits were about 40 per cent larger than the average in 1927-1929. Balances held by member banks in June 1940 represented 70 per cent of total deposits, excluding interbank balances, at all banks in the District; at the end of 1929 the proportion held by member banks was 60 per cent.

Continued expansion in deposits, which again was largest at banks in Philadelphia, was due for the most part to the extension of additional bank credit and to a heavy inflow of funds from other Districts. Demand balances increased more than \$236,000,000 to about \$2,350,000,000, while time deposits were somewhat reduced.

About four-fifths of the increase in balances available on demand was in those held for individuals and business concerns. The volume of funds held for other banks also expanded substantially, but the gain was less than one-half as large as that which occurred in the previous year. Deposits of states and municipalities and unclassified balances, which include certified and officers' checks, also increased somewhat, while balances held for the United States Government declined.

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While the volume of deposits is the largest on record, the use of these deposits continues at a low rate. Check payments reported by banks in the larger cities of the District increased only 6 per cent from 1939 to 1940, substantially less than the gain in the accounts against which the checks were drawn. At weekly reporting member banks the turnover of demand balances of individuals and business enterprises decreased from about 18 times in 1939 to 16½ times in 1940. At banks in smaller communities, the activity is generally somewhat less than this rate. Despite the sharp increase in deposits since 1927-29, check payments in 1940 were 30 per cent smaller than the average in the earlier period. This is due in part to the lower level of prices now and to the lack of activity in the securities markets.

The reduction of about \$15,700,000 to approximately \$1,100,000,000 in time deposits reflected a decrease in Philadelphia, where a member bank discontinued operations and transferred its time deposits to a nonmember institution. At country banks in this District, savings deposits increased about 1 per cent from 1939.

Deposits at member banks Philadelphia Federal Reserve District (Millions of dollars)	December 31, 1940	Changes in—	
		1939	1940
Demand:			
Individuals, partnerships, and corporations.....	1,640	+220	+187
U. S. Government.....	62	+ 1	- 16
States and political subdivisions.....	131	+ 20	+ 7
Interbank.....	490	+117	+ 51
Other.....	30	+ 2	+ 7
Total demand.....	2,353	+360	+236
Time:			
Individuals, partnerships, and corporations.....	1,050	+ 10	- 6
Postal savings*.....	7	- 1	- 3
States and political subdivisions.....	31	- 4	+ 0
Interbank.....	11	+ 5	- 6
Total time.....	1,099	+ 10	- 15
Total deposits.....	3,452	+370	+221
Philadelphia banks.....	1,772	+269	+127
Country banks.....	1,680	+101	+ 94

* Includes U. S. Treasurer's time deposits, open account.

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Loans and discounts Loans and discounts of the member banks in this District increased \$74,400,000 in 1940 to about \$1,020,000,000, the highest point since 1934. The principal increase was in advances to trade and industry, where larger inventories and generally more active business expanded the requirements for working capital. Extension of credit for the purchase of real estate and the construction or renovation of buildings increased, and miscellaneous advances to finance consumer purchases and other unclassified transactions were larger than in 1939. The demand for bank credit in the form of loans and discounts during the year was the most active in more than a decade, but the volume extended was still small in relation to the amount of funds available for lending.

Bank loans to commerce, industry, and agriculture in 1940 increased about \$41,000,000 in this District, a gain about twice that reported for 1939. Additional credit amounting to about \$15,000,000 was extended to business through the purchase of open market paper. The increase in advances to business enterprises was in evidence in both city and country banks during the year.

Loans on real estate were increased over \$13,000,000, as residential construction continued at a high level and many plants were renovated and new factories erected. At country banks, real estate loans increased

Loans of member banks Phila. Fed. Res. District (Millions of dollars)	Actual—Dec. 31, 1940			Changes in 1940		
	Phila- delphia banks	Coun- try banks	All member banks	Phila- delphia banks	Coun- try banks	All member banks
Commercial.....	217.2	150.0	367.2	+29.2	+11.6	+40.8
Open market paper.....	27.7	24.4	52.1	+ 9.1	+ 5.9	+15.0
Brokers' loans.....	22.1	3.3	25.4	+ 1.0	- 1.3	- .3
Other loans to carry securities	25.5	33.1	58.6	+ 3.1	- 5.7	- 2.6
Real estate loans.....	33.4	225.0	258.4	- 6.3	+19.7	+13.4
Loans to banks.....	.8	.2	1.0	.....	.....	.....
Other loans.....	86.8	170.3	257.1	+ 8.2	- .1	+ 8.1
Total loans.....	413.5	606.3	1,019.8	+44.3	+30.1	+74.4

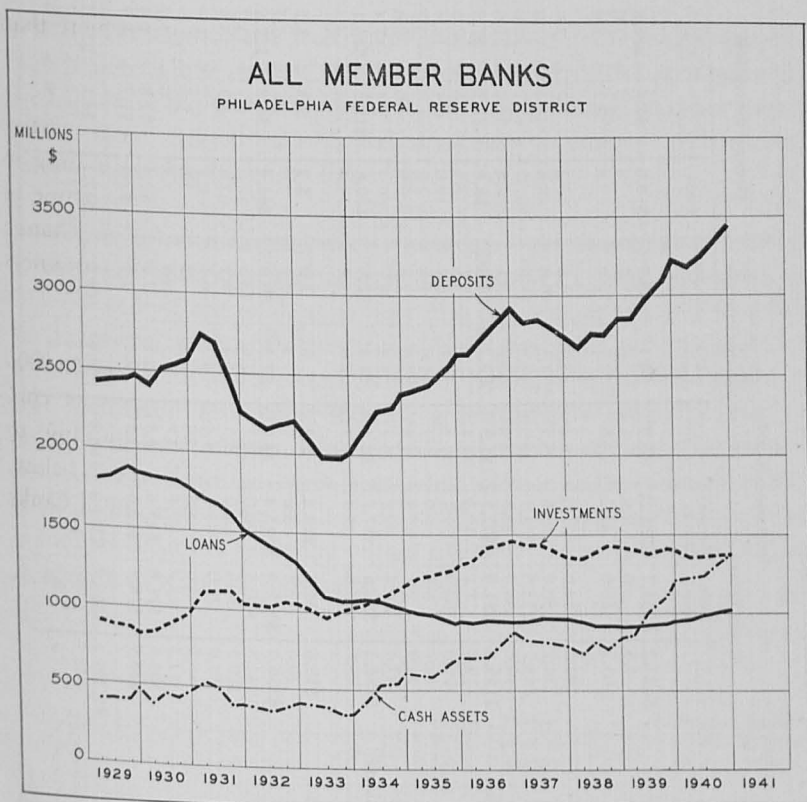
by nearly 10 per cent and at the end of the year comprised more than one-third of the total loans of these institutions.

The demand for credit to purchase or carry securities was inactive in 1940. Domestic and international uncertainties restricted trading in the equity market, and prices continued generally low. The volume of loans to brokers and dealers in securities showed virtually no change from 1939 at banks in this District, and security loans to other customers declined slightly.

Unclassified paper held in loan portfolios increased about \$8,000,000 in 1940, as banks participated more actively in the field of consumer credit. The volume of loans to consumers, amounting to about 7 per cent of total bank loans, is indicated in the table below, which represents preliminary tabulations of reports from member banks in this District as of the end of 1940.

Member banks Philadelphia Federal Reserve District (Millions of dollars)	Philadelphia banks	Country banks	Totals
Retail installment paper:			
Purchased.....	17.7	9.0	26.7
Direct loans.....	1.4	5.4	6.8
Title I loans.....	3.7	8.3	12.0
Personal installment cash loans.....	7.1	9.3	16.4
Total.....	29.9	32.0	61.9

Surveys made by the American Bankers Association indicate increased activity in bank lending. Summaries covering two-fifths of the commercial banks in Pennsylvania, New Jersey, and Delaware showed that the number of credit transactions increased from 1,454,000 in the first six months of 1939 to 1,536,000 in the same period of 1940, and the dollar volume expanded about \$51,000,000 to \$1,798,000,000. The number of new mortgage loans advanced by 1,000 to 11,000, and new loans of other types from 387,000 to 474,000, representing a combined dollar increase from \$576,000,000 to \$724,000,000. Renewals declined somewhat in the period. Lending was active in the second half of 1940.



Investments

Security holdings of member banks in this District declined further in 1940, despite the continued large volume of idle bank funds and the generally strong market conditions. Investments in the aggregate were reduced about \$17,000,000 to approximately \$1,380,000,000, reflecting decreases of \$4,600,000 at Philadelphia banks and \$12,500,000 at other banks in the District. The relation of investments to total loans and investments at all member banks was reduced in the year from 60 per cent to 57 per cent, owing in part to increased demand for commercial credit.

Most of the decline occurred in the first part of the year, when bond prices were strong, after having recovered from the lows reached

Analysis of Member Bank Investments

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Philadelphia Federal Reserve District (Dollar figures in millions)	December 31, 1940						Changes during 1940		
	Actual figures			Percentage distribution			Total	Phila. banks	Country banks
	Total	Phila. banks	Country banks	Total	Phila. banks	Country banks			
U. S. Government direct obligations	\$623.2	\$334.7	\$288.5	45.2%	50.1%	40.7%	+\$10.0	-\$7.8	+\$17.8
Treasury bills.....	1.5	0	1.5	.1	0	.2	+.8	-.2	+ 1.0
Treasury notes.....	63.2	18.0	45.2	4.6	2.7	6.4	-.8	- 2.7	+ 1.9
Bonds maturing—									
Within 5 years.....	50.0	19.0	31.0	3.6	2.9	4.4	+ 16.2	+ 7.2	+ 8.9
5 to 10 years.....	114.2	50.4	63.8	8.3	7.5	9.0	- 48.4	- 41.4	- 7.0
10 to 20 years.....	344.7	213.0	131.7	25.0	31.8	18.6	+ 101.1	+ 67.2	+ 34.0
Over 20 years.....	49.6	34.3	15.3	3.6	5.2	2.1	- 58.9	- 37.9	- 21.0
Obligations guaranteed by U. S. Government	\$159.0	\$81.9	\$77.1	11.5%	12.2%	10.9%	-\$8.8	-\$1.3	-\$7.5
Reconstruction Finance Corporation.....	19.4	7.1	12.3	1.4	1.1	1.7	+ 3.4	+.8	+ 2.6
Home Owners' Loan Corporation.....	98.0	60.9	37.1	7.1	9.1	5.2	- 19.0	- 4.1	- 14.9
Federal Farm Mortgage Corporation.....	16.7	6.8	9.9	1.2	1.0	1.4	- 2.2	+ 1.0	- 3.2
All other.....	24.9	7.1	17.8	1.8	1.0	2.5	+ 9.0	+ 1.0	+ 8.0
Maturing within 5 years.....	83.6	36.4	47.2	6.1	5.4	6.7	+ 10.4	+ 3.1	+ 7.3
Obligations of states and political subdivisions ..	\$184.3	\$96.6	\$87.7	13.4%	14.4%	12.4%	+\$30.6	+\$15.5	+\$15.1
Maturing within 5 years.....	83.7	46.6	37.1	6.1	7.0	5.2	+ 15.3	+ 10.8	+ 4.5
Other bonds, notes and debentures:									
Government corporations and agencies, not gtd....	\$18.6	\$4.2	\$14.4	1.3%	.6%	2.0%	+\$ 2.	-\$ 5.	+\$ 7.
Maturing within 5 years.....	10.6	2.6	8.0	.7	.4	1.1	+ 1.5	+.2	+ 1.3
Other domestic corporations.....	\$330.7	\$117.3	\$213.4	24.0%	17.5%	30.0%	-\$44.4	-\$6.8	-\$37.6
Railroads.....	146.8	50.8	96.0	10.7	7.6	13.5	- 12.5	+ 1.7	- 14.2
Public utilities.....	100.5	34.5	66.0	7.3	5.2	9.3	- 22.4	- 6.9	- 15.5
Industrials.....	74.9	29.0	45.9	5.4	4.3	6.4	- 6.9	+.1	- 6.9
All other.....	8.5	3.0	5.5	.6	.4	.8	- 2.6	- 1.7	-.9
Maturing within 5 years*.....	51.1	23.4	27.7	3.7	3.5	3.9	- 1.3	0	- 1.2
Corporate stocks, domestic	\$34.6	\$19.0	\$15.6	2.5%	2.8%	2.2%	-\$2.4	-\$2.0	-\$ 4.
Foreign securities	\$28.7	\$16.1	\$12.6	2.1%	2.4%	1.8%	-\$2.4	-\$1.7	-\$ 7.
Total investments	\$1,379.1	\$669.8	\$709.3	100.0%	100.0%	100.0%	-\$17.1	-\$4.6	-\$12.5
Maturing within 5 years.....	343.7	146.0	197.7	24.9	21.8	27.9	+ 42.0	+ 18.4	+ 23.7
Defaulted securities.....	9.1	3.9	5.2	.7	.6	.7	- 4.0	- 2.0	- 2.0

* Includes foreign securities.

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in late 1939 following the declaration of war. During the second quarter there was very little change, and holdings were expanded somewhat in the balance of the year. In early 1941, security holdings were increased further when prices declined and the large volume of government defense financing began to come into the market.

Maturities of member bank investments were shortened somewhat in the year. Securities maturing within five years were increased to 24.9 per cent of the total, as against 21.6 per cent at the end of 1939. In the case of government securities there was some accumulation of short term bonds and a concentration of holdings in the ten to twenty year maturities. This latter increase approximately offset declines in holdings of issues maturing in five to ten years and of long term securities. Average maturities were somewhat shorter at the country banks than at institutions in Philadelphia. The following table shows the volume of securities maturing within five years at banks in this District as compared with the country as a whole.

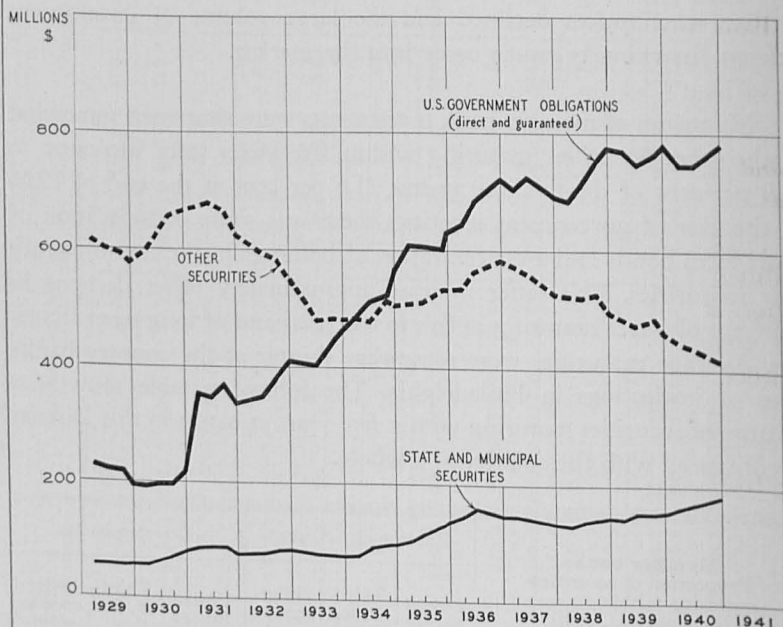
Member banks Proportion of securities maturing within 5 years December 31, 1940	Reserve city banks*			Country banks		
	United States	Third F. R. Dist.	Difference in points	United States	Third F. R. Dist.	Difference in points
Types:						
U. S. Government direct issues..	32.3%	11.1%	-21.2	28.4%	26.9%	- 1.5
Guaranteed securities.....	56.3	44.4	-11.9	55.0	61.1	+ 6.1
State and local government.....	53.9	48.2	- 5.7	52.5	42.3	-10.2
Government agencies, not guar...	83.0	61.9	-21.1	56.0	55.9	- .1
Other bonds, notes, debentures...	28.8	17.5	-11.3	15.7	12.3	- 3.4
Total investments.....	39.2%	21.8%	-17.4	34.8%	27.9%	- 6.9

* Excluding central reserve city banks.

Holdings of obligations of governments and government agencies increased about \$32,000,000 in the year, reflecting a substantial increase in the securities of states and municipalities and a small expansion in United States Government issues. The increase in Federal securities was entirely at country banks. Sales of bonds maturing in five to ten years and over twenty years were substantial. The volume of guaranteed

INVESTMENTS OF ALL MEMBER BANKS

PHILADELPHIA FEDERAL RESERVE DISTRICT



issues in investment portfolios of member banks was reduced, particularly the obligations of the Home Owners' Loan Corporation. At the end of the year, direct and guaranteed issues of the Federal Government and obligations of state and local governments comprised 77 per cent of the total investments at Philadelphia banks and 64 per cent at country banks.

Holdings of corporate securities declined substantially, particularly in the case of obligations of railroads and public utilities held by country banks. At the end of the year holdings of railroad and public utilities issues comprised 18.0 per cent of the total investments of member banks in this District as against 20.2 per cent in 1939; holdings of these securi-

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ties by all member banks in the country decreased from 6.7 per cent in 1939 to 5.5 per cent of total investments at the end of 1940.

Bank investments in foreign securities were reduced further in 1940, and at the end of the year these issues represented only 2 per cent of total bank investments.

Capital funds

The volume of capital funds at member banks in this District declined somewhat in 1940, while deposits increased to new high levels. The cushion of capital against liabilities, however, continued larger than in the country, and the proportion of assets held as cash expanded. Capital accounts in the aggregate were in a more liquid position than in 1939, as the amount absorbed by real estate holdings declined considerably.

The ratio of capital funds to deposit liabilities was reduced in the year from 15.2 to 14 per cent, owing to the sharp increase in deposits and a decline of \$7,700,000 in capital to \$482,300,000. This decrease re-

All member banks end of year	Philadelphia Federal Reserve District		United States
	1939	1940	1940
Capital accounts: Percentage of—			
Deposits.....	15.2%	14.0%	10.1%
Loans, investments, and real estate assets*.....	19.5	18.9	14.8
Investments.....	35.1	35.0	26.1
Investments other than U. S. Government obligations.....	79.6	80.8	95.2
Surplus, undivided profits and reserves:			
Percentage of—			
Loans, investments, and real estate assets*.....	12.0	11.8	8.7
Investments.....	21.6	21.8	15.3
Investments other than U. S. Government obligations.....	49.0	50.3	55.9
Banking house, equipment, and other real estate*: Percentage of—			
Capital accounts.....	35.2	31.6	22.0

* Includes assets indirectly representing real estate.

sulted primarily from the withdrawal from membership and subsequent liquidation of a bank in the early part of the year. The ratio of capital funds to deposits at banks in Philadelphia at the end of December was 10.5 per cent as against 9.6 per cent at all reserve city member banks. In the case of country banks, the ratio in this District was 17.6 per cent as compared with only 12.6 per cent at banks of this type throughout the country.

The cushion of capital funds against depreciable assets was also reduced slightly to about 19 per cent, after having averaged 19.5 per cent during the several preceding years. By December about 32 per cent of capital funds represented banking houses and equipment and other real estate assets as compared with more than 35 per cent in the previous year. In all member banks of the System, however, the proportion was only 22 per cent.

Earnings and expenses	Net earnings from current operations of member banks in this District increased slightly further from 1939 to 1940. Supplementary income from recoveries and profits on sales, however, declined substantially, and losses and depreciation continued around the high levels prevailing the year before. As a result, net profits available for distribution were reduced from \$21,200,000 in 1939 to \$16,600,000. Payments of cash dividends were sustained at about \$17,400,000.
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Total income from current operations was reduced about \$2,000,000 in 1940 to \$105,800,000. This was due chiefly to a decline in earnings on investments, which yielded an average of 3 per cent during the year as compared with 3.2 per cent in 1939. Miscellaneous income also declined somewhat, but this was more than offset by increases in the returns from loans, operations of trust departments, and service charges on deposits.

Current expenses were reduced in 1940. Payments of interest on time and savings deposits declined substantially to 1.3 per cent compared with 1.5 per cent in 1939. Sharp reductions in the rates paid on

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time and savings deposits and the elimination of interest on demand deposits have decreased this cost to only 21 per cent of total expenses in 1940 as compared with 45 per cent in 1929, although these changes are offset to some extent by the deposit insurance assessment that was not made prior to 1934. Miscellaneous expenses were also reduced somewhat from 1939, but this was offset by increased taxes.

Earnings and expenses of member banks Philadelphia Federal Reserve District (000's omitted)	1938	1939	1940
Current earnings:			
Interest and discount on loans.....	\$41,501	\$42,099	\$43,034
Interest and dividends on securities.....	46,007	44,772	41,289
Trust department.....	9,168	8,827	9,904
Service charges on deposits.....	2,317	2,501	2,707
All other.....	9,399	9,684	8,895
Total.....	\$108,392	\$107,883	\$105,829
Current expenses:			
Salaries and wages.....	\$27,498	\$27,616	\$27,624
Interest on time and savings deposits.....	18,474	16,557	14,325
Taxes—real estate.....	2,738	2,795	2,710
Taxes—other.....	4,754	5,149	5,420
All other.....	19,612	19,863	19,693
Total.....	\$73,076	\$71,980	\$69,772
Net earnings from current operations....	\$35,316	\$35,903	\$36,057
Recoveries and profits on sales:			
Recoveries on loans.....	\$1,449	\$1,867	\$1,953
Recoveries on securities.....	3,097	6,218	3,815
Profits on security sales.....	10,631	16,630	13,341
All other.....	1,509	1,279	1,545
Total.....	\$16,686	\$25,994	\$20,654
Losses and depreciation:			
On loans.....	\$10,625	\$12,167	\$11,920
On securities.....	22,067	18,706	17,871
On banking house and equipment.....	2,705	3,053	3,445
All other.....	6,631	6,773	6,889
Total.....	\$42,028	\$40,699	\$40,125
Net addition to profits.....	\$9,974	\$21,198	\$16,586
Cash dividends declared.....	17,982	17,385	17,369

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Recoveries on loans were larger in 1940 than a year earlier, but recoveries of charge-offs and profits from sales of securities were substantially reduced, so that total supplementary income during the year was about \$5,300,000 less than in 1939. Losses and depreciation were slightly reduced, owing to smaller charge-offs on loans and securities. Depreciation on bank buildings and equipment and on other assets was increased.

Bank earnings have declined sharply since the late 1920's, when a record volume of credit was being extended. This decrease has reflected two principal influences: the shift in earning assets from relatively high-yielding loans to securities that bring a low return, and the sharp decline in money rates. While deposits of all member banks in this District increased 35 per cent from the average in 1927-29 to 1940, total current earnings were reduced by one-third. Smaller demands for credit on the part of business enterprises and extensive use of the open market for current financing resulted in a decline of more than 40 per cent in the volume of bank loans. As credit has been extended at decreasing interest costs, the earnings from loans in this period were reduced by 55 per cent.

All member banks Philadelphia Federal Reserve District	1927-29 (average)	1940	Per cent change
Deposits.....	\$2,434,000,000	\$3,295,000,000	+35%
Loans.....	1,718,000,000	985,000,000	-43
Earnings on loans.....	95,500,000	43,000,000	-55
Investments.....	924,000,000	1,365,000,000	+48
Earnings on investments.....	46,800,000	41,300,000	-12
Earnings from other sources.....	16,000,000	21,500,000	+34
Total current earnings.....	158,300,000	105,800,000	-33

The decrease in the volume of loans was offset to a large extent by the expansion in security holdings, as banks turned to the open market to employ their funds. The large volume of idle money, however, and

the competitive purchases of securities so reduced money rates that, despite an increase of nearly 50 per cent in the volume of bank investments during this period, the income from investments was reduced by 12 per cent. Some part of these losses of income has been offset by the imposition of service charges and other miscellaneous fees, but this has proved on the whole to be a minor influence on earnings.

Money Rates

Money rates in 1940 generally declined further, reaching in some cases the lowest levels on record. While the demand for funds expanded to meet requirements for financing defense production and general industrial activity, the supply was again increased substantially. A record inflow of funds to this country resulted from payment and commitments for purchases of war materials and transfers of short term capital owing to disrupted conditions abroad.

The only significant interruption to the downward trend occurred in May and June, when rates advanced sharply during the critical invasion of the Low Countries and France. As large volumes of funds continued to move into the country, however, security prices recovered and rates resumed their decline to reach a record low point in December. Yields were firmer again in early 1941 as it became apparent that the public and private demand for funds would expand sharply, while the increase in the supply of funds from abroad would be at a much slower rate than in the several preceding years. The volume of trading in the securities markets continued light, owing to the uncertainty as to the effects of impending critical developments in the war and changes in the amount and methods of financing in this country.

The inflow of gold to the United States was at a record high during 1940 and the amount of funds available for investment increased sharply. The excess reserves of all member banks of the Federal Reserve

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System expanded by \$1,400,000,000 to \$6,600,000,000 at the end of the year. This was nearly 90 per cent above legal requirements and would support a large volume of additional credit. Deposits at member banks, excluding interbank balances, increased sharply to the record level of \$46,000,000,000, most of the gain being in balances of individuals and business concerns. Idle funds held by banks, insurance companies, and investment trusts increased further during the year.

The use of bank credit expanded considerably, chiefly because of more active demand for commercial loans and large purchases of government securities. Funds required for construction of plants, the production of defense equipment and materials, the manufacture and distribution of consumers' goods, and government expenditures under the defense program are expected to be substantially larger in 1941 than in the previous year.

Activity in the capital market also increased somewhat in 1940, with indications of further advances in the current year. Cash allotments of direct government issues other than savings bonds and bills advanced from about \$500,000,000 in 1939 to more than \$1,000,000,000 in 1940, and investment by individuals in savings issues was larger. Flotations of other securities to obtain new capital were reported to have declined from about \$2,300,000,000 to around \$1,900,000,000, the smallest since 1935. This was due chiefly to a reduction of about 50 per cent in offerings by Federal agencies, which amounted to more than \$900,000,000 in 1939. Flotations of state and municipal securities also were reduced somewhat from about \$930,000,000 to approximately \$760,000,000. Corporate offerings for new capital, however, nearly doubled in the year, expanding from about \$380,000,000 in 1939 to over \$720,000,000.

Generally favorable market conditions continued to stimulate re-funding operations to reduce carrying charges. The volume of these securities, excluding direct issues of the Treasury, declined from \$3,600,000,000 in 1939 to \$2,800,000,000 in 1940.

Rates on short term securities generally declined further in 1940 to new low points. The average yield on outstanding 91-day Treasury bills was reduced from .05 per cent to .04 per cent. At certain times in the year new issues sold at par or more than par, as purchases on a negative-yield basis were made for tax purposes. The average return on 3 to 5 year Treasury notes declined from .59 in 1939 to .50 per cent and at the end of 1940 they were selling to yield .38 per cent.

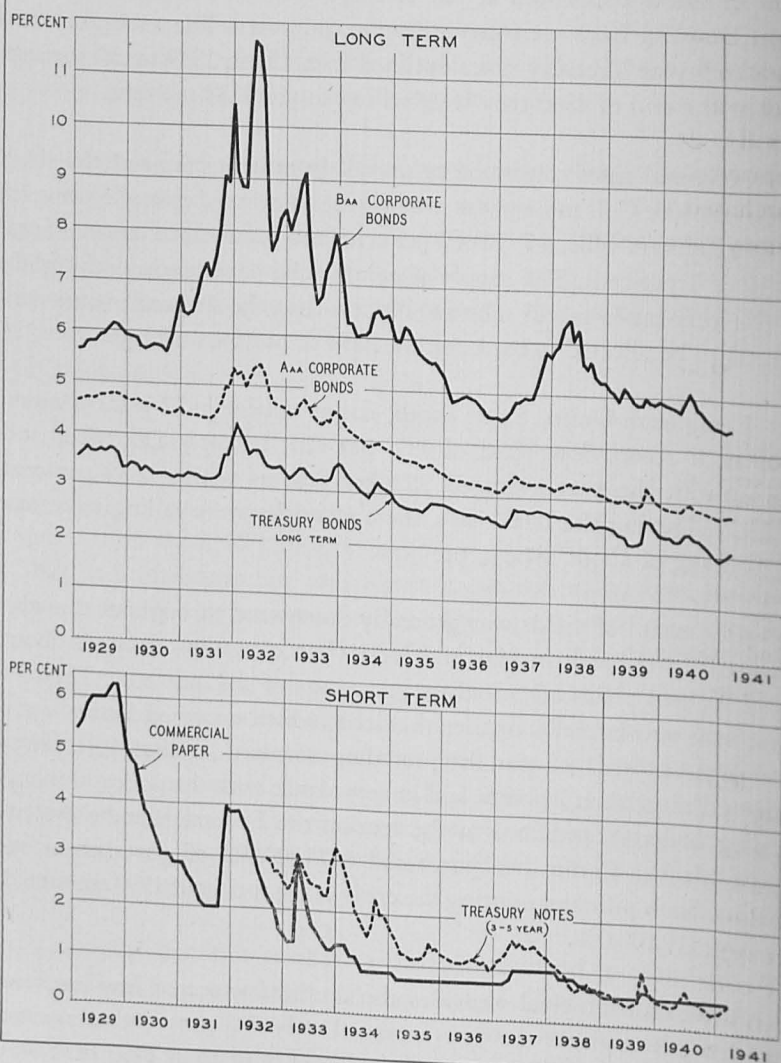
Nominal rates continued to prevail in other sections of the short term market. Call money was available at an average cost of 1 per cent, 90-day bankers' bills at $7/16$ of 1 per cent, and commercial paper at from $1/2$ - $3/8$ of 1 per cent. The supply of commercial paper expanded slightly in the year but was still substantially less than the demand; issues continued to be allotted to banks on the basis of previous takings.

Long term United States bonds, due or callable in 12 years or more, sold at a record low yield of 1.86 per cent in early December and throughout the year averaged 2.21 per cent as against 2.36 per cent in 1939. During the late 1920's, these securities were selling to return an average of about $3\frac{1}{4}$ - $3\frac{3}{4}$ per cent.

The trend of yields was generally downward throughout the year except for the break in May and June when quotations dropped about 3 points and yields advanced to an average of $2\frac{1}{2}$ per cent. This decline was substantially smaller than that which occurred immediately after the outbreak of war the preceding autumn. At that time prices dropped more than 7 points, and in accordance with the policy of maintaining orderly conditions in the market the Federal Reserve System Open Market Committee purchased \$470,000,000 of government securities. Such purchases during the crisis in the spring of 1940 amounted to only \$10,000,000.

Rates on municipal securities also declined to record low levels in 1940 and throughout the year averaged only $2\frac{1}{2}$ per cent as against $2\frac{3}{4}$ per cent in 1939. A low point of slightly more than 2 per cent was

MONEY RATES



reached in December. The supply of these issues was generally regarded as somewhat small in relation to demand. Yields on high grade corporate securities declined substantially to an average of 2.84 per cent in the case of issues of the Aaa grade as compared with slightly more than 3 per cent in 1939. In May and June yields reached the comparatively high level of 3.05 but by December a new low of 2.70 per cent was established. Average returns on lower grade corporate securities also declined to record low levels toward the end of 1940 as income improved and some investing institutions in search of additional income purchased increasing amounts of these issues. In the early part of 1941 money rates became somewhat firmer.

Money rates and yields	Annual averages			End of year	
	1938	1939	1940	1939	1940
Commercial paper, prime.....	.81%	.59%	.56%	.56%	.56%
Bankers' acceptances, 90 days.....	.44	.44	.44	.44	.44
Call money renewals, New York.....	1.00	1.00	1.00	1.00	1.00
Treasury bills, 91-day (dealers).....	.07	.05	.04	.04	.02
Treasury notes, 3-5 year.....	.83	.59	.50	.46	.38
Treasury bonds, over 12 years.....	2.56	2.36	2.21	2.30	1.88
Municipal bonds (Standard Statistics)...	2.91	2.76	2.50	2.52	2.06
Corporate bonds (Moody):					
Aaa.....	3.19	3.01	2.84	2.91	2.71
Baa.....	5.80	4.96	4.75	4.89	4.42
Industrials.....	3.50	3.30	3.10	3.15	2.91
Rails.....	5.21	4.53	4.30	4.44	4.00
Utilities.....	3.87	3.48	3.25	3.36	3.14

Rates on commercial loans generally were lower in 1940 than in 1939, but, in the latter part of the year, increased as demand for this type of accommodation expanded. Reports from seven large Philadelphia banks indicate that the average interest rate on loans maturing in 30 days or more declined to about 2.8 per cent in 1940 as against 3.3 per cent in 1939. The low, indicated by these quarterly reports, was 2.6 per cent in June, and in December the level of 2.8 was slightly higher than a year earlier. Most of the small loans were made at rates between 5 and 6 per cent, three-fifths of the total in December being in this group. In dollar volume, however, nearly 40 per cent of this credit was

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Commercial and industrial loans maturing in 30 days or more made by seven Philadelphia banks (Dollar figures in thousands)	June 1-15, 1939	Dec. 1-15, 1939	June 1-15, 1940	Dec. 1-15, 1940
Rate				
1 per cent.....	\$ 211	\$ 1,167	\$ 261	\$ 254
Between 1 and 1½ per cent.....	250	500	0	600
1½ per cent.....	2,080	10,151	10,755	8,960
Between 1½ and 2 per cent.....	150	115	99	200
2 per cent.....	332	754	1,261	2,306
Between 2 and 3 per cent.....	548	2,260	734	1,028
3 per cent.....	3,096	2,460	2,394	4,290
Between 3 and 4 per cent.....	1,265	2,824	2,135	1,032
4 per cent.....	2,147	2,550	1,984	3,514
Between 4 and 5 per cent.....	1,767	948	664	800
5 per cent.....	1,350	1,614	1,269	2,052
Between 5 and 6 per cent.....	250	249	180	124
6 per cent.....	1,547	1,179	901	792
Between 6 and 7 per cent.....	0	9	3	0
Total, dollar amount.....	\$14,993	\$26,780	\$22,640	\$25,952
Total number of loans.....	991	1,115	1,054	1,195
Average rate, based on dollar volume.....	3.6%	2.7%	2.6%	2.8%

extended at a rate of 1½ per cent or less and only about 10 per cent was in the highest range. The accompanying table indicates the volume of this credit extended by the reporting banks at various rates in 1939 and 1940.

Interest rates paid on time deposits by banks in this district declined further in 1940, averaging about 1.6 per cent among the individual banks as compared with 1.8 per cent in 1939 and 1.9 per cent in 1938. Maximum rates allowable were not changed in the year. In New Jersey the maximum of 1 per cent, established by the Commissioner of Banking and Insurance and applying to all banking institutions in the State, remained in effect. In the rest of the District, where the maximum is the same as that prescribed by the Board of Governors of the Federal Reserve System, the limit of 2½ per cent on postal savings, savings and other time deposits payable in six months or more, continued

Interest rates charged on various types of credit extended by the Federal Reserve Bank of Philadelphia in 1940 continued generally a

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Discount and interest rates Federal Reserve Bank of Philadelphia	December 31, 1940
Discounts for member banks (Sections 13 and 13a).....	1½%
Advances to member banks under Section 10(b).....	2
Advances secured by U. S. Government direct obligations for individuals, partnerships and corporations under last paragraph of Section 13:	
To banks.....	1½
To others.....	2½
Rates on industrial advances—Section 13b:	
Advances direct to industrial or commercial organizations.....	3½-6
Advances to financing institutions—	
On portion for which institution is obligated.....	2½*
On remaining portion.....	**
Commitments to make advances.....	½-2

* May be same as rate to borrower, if lower than rate shown.

** Same as to borrower.

the record low levels established earlier. Rediscounts and advances to member banks under sections 13 and 13a of the Federal Reserve Act were made at 1½ per cent; advances on other types of collateral under the terms of section 10(b) were made at 2 per cent. Loans secured by direct obligations of the United States Government are available to banks at 1½ per cent and to others at 2½ per cent. In October, rates charged on advances for working capital purposes to established business concerns were reduced from a range of 4 to 6 per cent to a range of 3½ to 6 per cent. In cases where such paper is offered by financing institutions that have extended credit at lower rates, the rates may be as low as those charged the original borrower.

Federal Reserve Bank

The resources of the Federal Reserve Bank of Philadelphia increased \$150,000,000 further during 1940 to \$1,326,000,000. The gain was entirely in cash resources, reflecting an expansion in gold certificates resulting from the heavy inflow of gold to this country in trade and capital transactions.

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Statement of Condition

Federal Reserve Bank of Philadelphia (000's omitted in dollar figures)	End of year		
	1938	1939	1940
RESOURCES			
Gold certificates on hand and due from U. S. Treasury.....	\$546,461	\$846,062	\$1,046,557
Redemption fund—Federal Reserve notes.....	1,236	1,071	1,073
Other cash.....	29,221	26,470	18,754
Total reserves.....	\$576,918	\$873,603	\$1,066,384
Bills discounted:			
Secured by U. S. Government obligations*	704	150	187
Other bills discounted.....	473	513	278
Total bills discounted.....	\$1,177	\$663	\$465
Bills bought in open market.....	56	0	0
Industrial advances.....	3,120	3,084	2,052
United States Government securities.....	222,761	212,695	183,006
Total bills and securities.....	\$227,114	\$216,442	\$185,523
Due from foreign banks.....	17	5	5
Federal Reserve notes of other F. R. banks.....	2,081	1,945	1,865
Uncollected items.....	54,506	73,955	63,085
Bank premises.....	4,699	4,572	4,501
All other resources.....	4,637	5,830	4,910
Total resources.....	\$869,972	\$1,176,352	\$1,326,273
LIABILITIES			
Federal Reserve notes in circulation.....	\$320,562	\$348,938	\$410,704
Deposits:			
Member bank reserve account.....	374,231	598,597	703,580
U. S. Treasurer—general account.....	58,155	65,043	13,664
Foreign.....	19,545	39,416	75,944
Other deposits.....	6,899	16,821	26,675
Total deposits.....	\$458,830	\$719,877	\$819,863
Deferred availability items.....	57,591	73,866	60,412
Other liabilities.....	664	965	875
Total liabilities.....	\$837,647	\$1,143,646	\$1,291,854
CAPITAL ACCOUNTS			
Capital paid in.....	\$12,213	\$12,115	\$11,882
Surplus—Section 7.....	13,696	14,198	15,144
Surplus—Section 13b.....	4,416	4,393	4,393
Other capital accounts.....	2,000	2,000	3,000
Total liabilities and capital accounts.....	\$869,972	\$1,176,352	\$1,326,273
Ratio of total reserves to deposit and Fed. Res. note liabilities combined.....	74.0%	81.7%	86.7%
Contingent liability on bills purchased for foreign correspondents.....	\$7	\$0	\$0
Commitments to make industrial advances.....	1,525	930	162

* Includes bills secured by obligations fully guaranteed by United States Government.

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The volume of Reserve Bank credit outstanding declined, owing chiefly to sales of government securities from the System Open Market Account. In early 1941 there was some increase in the demand for industrial credit under section 13b, arising chiefly from requirements for funds to finance defense production. The volume of borrowing by member banks from the Reserve Bank has continued small.

The principal increase in liabilities was in holdings of member bank reserve balances. Foreign deposits held in participation with other Reserve Banks also increased somewhat. The note issue of this Bank expanded substantially as increases in wage disbursements and general business activity stimulated a heavy demand for currency. The only large decline among the liabilities was in Treasury balances.

The capital stock of the Bank decreased somewhat, but total capital funds were increased. Current earnings advanced and profits on sales of securities were substantially larger than the year before, while expenses showed little change.

*Reserve
bank
credit*

The demand for credit extended by the Federal Reserve Bank of Philadelphia in 1940 was small, as the volume of surplus funds held by member banks reached record levels and was widely distributed throughout the banking system. Participation by this Bank in holdings of government securities in the System Open Market Account was reduced from \$212,700,000 to \$183,000,000. This was due to sales by the Account and a decline in the allotment to this Bank. Holdings of the System Open Market Account were reduced from about \$2,826,000,000 at the peak in September 1939 to \$2,184,000,000 at the end of 1940.

Some individual institutions in temporary need of funds discounted obligations with the Reserve Bank. Of the 651 member banks in this District, only 45 made use of the discount facilities of the Reserve Bank during the year. The volume of such credit ranged from a low of \$10,000 on April 12 to a high of \$648,000 in December, when

the demand for currency reached the seasonal peak. In a few cases, advances were made on broader types of collateral under the provisions of section 10(b) of the Federal Reserve Act, but the largest volume so extended at any one time was \$57,000, and over a large part of the year none of these loans was outstanding.

As in 1939, no advances were made to individuals, partnerships, corporations, or nonmember banking institutions on the security of direct obligations of the United States Government, as authorized in the last paragraph of section 13 of the Federal Reserve Act. At various times during the year, discounts were increased somewhat by participation in foreign loans on gold made by the Federal Reserve Banks.

Industrial loans The demand for industrial loans in 1940 was smaller than in previous years, but in early 1941, as defense production expanded and the use of subcontracting facilities was extended, inquiries for this type of credit increased. Advances to commerce and industry by commercial banks rose considerably in the latter part of 1940 and continued to increase in 1941.

The volume of industrial loans under section 13b of the Federal Reserve Act reached a high point for the year of \$3,401,000 at the close of February, but subsequently declined to a low of \$2,052,000 at the end of the year. This was substantially below the peak of \$6,960,000 reached in the autumn of 1935, about a year and a half after the program was inaugurated, but was still the largest volume outstanding at any Federal Reserve Bank. Loans by this Bank outstanding at the end of the year accounted for 27 per cent of the total extended by the Federal Reserve System. Formal commitments to make advances declined sharply in 1940 to \$162,000, but this figure does not include an agreement to furnish up to \$2,500,000 to a local shipbuilding concern which has received a large government contract.

The number of inquiries for industrial credit declined from 89 in 1939 to 53 in 1940, and the number of formal applications declined from 27 to 20. The total volume requested in these applications, how-

ever, expanded about \$2,240,000 to \$7,295,000. Including one application for \$200,000 which was withdrawn in 1939 and reconsidered in 1940, the Bank approved 15 applications for a total amount of \$7,153,000. The number of requests for credit which were rejected was small and involved small amounts. Since this type of lending was begun in 1934, rejections have resulted primarily from the unsatisfactory financial condition or the doubtful business prospects of the establishments requesting credit. Several applications, totaling \$135,000, were still under consideration at the close of the year.

The action taken by this Bank upon applications received in 1940 and since the beginning of the program on June 30, 1934 is summarized in the following table.

Applications for industrial loans Federal Reserve Bank of Philadelphia	1940	June 30, 1934— Dec. 31, 1940
Number:		
Approved.....	15	223
Rejected.....	2	424
Withdrawn.....	-1*	48*
Under consideration.....	4	4
Total number.....	20	699
Dollar amount:		
Approved.....	\$7,153,000	\$39,981,000
Rejected.....	7,500	15,890,000
Withdrawn.....	-200,000*	2,259,000*
Under consideration.....	135,000	135,000
Total amount.....	\$7,095,500	\$58,265,000

* One application for \$200,000 withdrawn in 1939; reconsidered and approved in 1940.

Total income received on advances and commitments for industrial loans since the middle of 1934 amounted to \$1,277,100, of which \$171,500 or 13.4 per cent was absorbed by realized losses or necessary reserves against losses. Expenses incurred in the extension of this credit amounted to \$389,900, leaving a net income of \$715,700 for the period as a whole. Of this amount, \$350,000 was paid to the Treasury of the United States, representing earnings on funds turned over to this Bank for the purpose of extending credit under section 13b. The experience

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of the Federal Reserve Bank of Philadelphia as well as of other institutions engaged in this type of lending indicates that a substantial degree of risk is involved and larger than customary reserves are required as a protection against possible loss.

*Volume
of work*

The volume of work at the Federal Reserve Bank increased substantially in 1940 with the expansion in general business and banking activity. The number of ordinary checks handled advanced from 97,200,000 to 100,400,000 in the year, and the dollar amount from \$23,500,000,000 to \$26,900,000,000. An additional 16,800,000 items were handled in packages by the automobile run service.

The volume of Federal Reserve notes of this Bank in circulation expanded to \$411,000,000 at the end of 1940 from \$349,000,000 a year earlier. Because of the increasing demand for hand-to-hand currency, the number of notes returned to the Bank advanced only about 3,000,000 to 169,400,000. In the case of coins, over 295,000,000 were counted in the year as against about 273,000,000 in 1939.

The volume of subscriptions for direct and guaranteed government securities received by the fiscal agency department declined from \$1,116,000,000 in 1939 to \$816,000,000 in 1940, owing to a reduction in offerings of new securities of government agencies. Allotments in this District were reduced from \$223,000,000 to \$121,000,000, but the number of obligations issued, redeemed, or exchanged increased. In the case of direct issues, there was an expansion of 46,000 to 240,000, while transactions involving securities of government agencies declined from 52,000 to 16,000. The number and value of coupons on government securities handled by this Bank decreased slightly, and fewer work relief checks were paid than in 1939. Owing to sharply increased expenditures under the National Defense Program, however, the number of government checks handled was substantially larger than the year before.

The volume of other collection items showed little change in the year. Transfers of funds declined somewhat and extensions of credit

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to banks and businesses continued negligible. The work of some departments, however, was increased substantially as a result of the defense program. A large volume of information on defense and general business activity and on problems involving the obtaining, execution, and financing of government contracts was distributed in the year. The Bank cooperated closely with business enterprises and banking institutions in an effort to facilitate the general coordination of industry, trade, and finance under the defense program.

The Bank held in custody for member banks an average of \$636,000,000 in securities during 1940 and cleared 451,000 coupons on these securities during the year. The number of savings bonds held in custody for purchasers increased to 9,823, or nearly double the number a year earlier. The volume of security transactions handled for member banks was again in excess of \$300,000,000, but the number of transactions declined from over 16,000 to about 14,400. The following table indicates the number of various transactions carried on by the Bank during 1939 and 1940.

Volume of work Federal Reserve Bank of Philadelphia	Pieces or trans- actions handled (000's omitted)		Dollar amounts (000,000's omitted)	
	1939	1940	1939	1940
Discounts and advances.....	*	1	\$11	\$6
Currency counted.....	166,628	169,391	677	688
Coins counted.....	273,429	295,186	26	28
Ordinary checks.....	97,232	100,442	23,467	26,922
Checks handled in packages by auto- mobile run service.....	16,370	16,782	.....	.....
U. S. Government checks.....	3,117	3,821	669	795
Work relief checks.....	5,613	4,676	160	126
Collection items:				
Coupons of U. S. Government and agencies.....	1,230	1,117	50	48
All other (notes, drafts and coupons).....	337	335	197	201
Transfers of funds.....	56	54	3,197	3,105
Issues, redemptions and exchanges by fiscal agency department:				
U. S. Government direct obligations.....	194	240	396	340
All other.....	52	16	122	23

* Less than 500.

An addition to the Federal Reserve Bank building was started in 1940 and is scheduled for completion in the summer of 1941. Designed by Dr. Paul Cret and erected by Irwin and Leighton, the structure will comprise six stories and a mezzanine, providing 22,500 additional square feet of floor-space. The service departments will be housed in the new addition, and parking facilities will be available in an underground garage. In front of the building will be a fountain, flowers, shrubbery, and flagged walk.

***Earnings
and
expenses***

The income of this Bank from current operations, of which 95 per cent comprised earnings on government securities, increased from \$3,264,000 in 1939 to \$3,607,000 in 1940. In spite of the increase in routine work and the expansion of activities in connection with the defense program, expenses were maintained at approximately the same level as in 1939, so that current net earnings advanced from \$923,000 to \$1,240,000. Total funds made available for distribution in 1940 reached a new high since 1932 of \$2,717,000. This compared with \$1,205,000 in 1939 and \$1,053,000 in 1938.

Dividends again exceeded \$700,000, and approximately \$56,000 was paid to the Treasury of the United States, representing the earnings on funds turned over to this Bank for the purpose of making industrial advances. Nearly \$1,950,000 was added to the surplus established under section 7 of the Federal Reserve Act, and \$1,000,000 was transferred from this surplus to a reserve for contingencies, increasing this reserve to \$3,000,000.

***Member-
ship***

The number of member banks in the Third Federal Reserve District at the end of 1940 was 651, or 1 less than a year earlier. Four state banking institutions, 2 in Pennsylvania and 2 in New Jersey, were admitted to membership, but one state bank member withdrew and its deposits were assumed by a national bank and a mutual savings institution. Four national banks were absorbed by or consolidated with other member banks, reducing the

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Profit and loss account Federal Reserve Bank of Philadelphia (000's omitted)	1939	1940
Earnings from:		
Bills discounted.....	\$7	\$5
Bills bought.....	0	0
Industrial advances.....	133	121
United States Government securities.....	3,070	3,426
Other sources.....	54	55
Total earnings.....	\$3,264	\$3,607
Expenses:		
Operating expenses*.....	\$2,080	\$2,106
Cost of Federal Reserve currency.....	103	96
Assessment for expenses of Board of Governors.....	158	165
Total net expenses.....	\$2,341	\$2,367
Current net earnings.....	\$923	\$1,240
Additions to current net earnings:		
Profits on sales of U. S. Government securities.....	\$370	\$979
Transfers of reserves in excess of requirements.....	33	518
Other additions.....	4	7
Deductions from current net earnings.....	\$407	\$1,504
Net additions to current net earnings.....	\$282	\$1,477
Net earnings available for distribution.....	\$1,205	\$2,717
Distribution of net earnings:		
Paid to Treasury of United States, Sec. 13b.....	\$ 0	\$ 56
Dividends paid to member banks.....	725	714
Transferred from surplus (Sec. 13b).....	-22	0
Transferred to surplus (Sec. 7).....	502	1,947**

* After deducting reimbursements received for certain fiscal agency and other expenses.

** \$1,000,000 subsequently transferred from Surplus (Sec. 7) to reserve for contingencies.

total number of national banks from 586 to 582, while the number of state bank members increased from 66 to 69. Member banks also absorbed two nonmember state institutions.

The total number of banks in the Third Federal Reserve District declined from 932 to 918 in 1940. Total assets, however, were expanded from \$5,217,000,000 to \$5,408,000,000, of which approximately 73 per

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cent was held by member banks. Excluding mutual savings banks, the proportion of assets held by member institutions was about 84 per cent.

The number and total assets of banks in Delaware and in the sections of Pennsylvania and New Jersey included in this District are shown in the following table.

Banks in Philadelphia Federal Reserve District December 31, 1940 (Dollar figures in millions)	Pennsyl- vania*	New Jersey*	Delaware	District totals
Number of banks				
Total.....	759	105	54#	918
Member banks.....	548	84	19	651
Proportion—member of total.....	72%	80%	35%	71%
Total assets				
Total.....	\$4,622	\$458	\$328	\$5,408
Member banks.....	3,417	325	214	3,956
Proportion—member of total.....	74%	71%	65%	73%

* Portion of the state in Philadelphia Federal Reserve District.

Includes 9 branches of nonmember banks.

The number of national banks with fiduciary powers was reduced from 252 to 249 during the year, owing to the surrender of partial of restricted powers by two banks and the absorption of another national bank by a member trust company.

**Directors
and
officers**

There were no changes in the membership of the Board of Directors of this Bank during 1940, and one officer was added to the official staff. At the regular elections held in the autumn, C. Frederick C. Stout was reelected by the banks of Group 1 to serve as a Class B director for a term of three years, and John B. Henning was reelected by the banks in Group 3 to serve as a Class A director. Warren F. Whittier was reappointed by the Board of Governors of the Federal Reserve System as a Class C director. The terms of each of these directors is for three years beginning January 1, 1941.

As in 1939, Thomas B. McCabe served as Chairman of the Board and Federal Reserve Agent, and Alfred H. Williams as Deputy Chairman, serving by appointment of the Board of Governors of the Federal Reserve System. These terms were continued for 1941. Howard A. Loeb, Chairman of the Board of the Tradesmens National Bank and Trust Company of Philadelphia, after serving for ten years as the representative of this District on the Federal Advisory Council, asked that his name not be considered for reappointment. To succeed him, William Fulton Kurtz, President of the Pennsylvania Company for Insurances on Lives and Granting Annuities of this city, was selected to serve on the Council during 1941.

John S. Sinclair, President of this Bank, represented the Federal Reserve Banks of Philadelphia and Cleveland on the System Open Market Committee from March 1940 to March 1941. W. J. Davis, a Vice President, was designated in November as field representative of the Director of Small Business Activities and of the Board of Governors to serve in facilitating the financing of defense production. John McDowell, previously associated with the local office of the Reconstruction Finance Corporation, was appointed an Assistant Vice President in July.

At the close of the year, there were 783 employees other than officers in the Bank. This compared with 769 at the end of 1939.



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Directors
as of March 31, 1941

	<i>Group</i>	<i>Term expires Dec. 31</i>
Class A:		
Joseph Wayne, Jr. Chairman of Board, Philadelphia National Bank, Philadelphia, Pennsylvania.	1	1941
George W. Reily President, Harrisburg National Bank, Harrisburg, Pennsylvania.	2	1942
John B. Henning President, Wyoming National Bank, Tunkhannock, Pennsylvania.	3	1943
Class B:		
C. Frederick C. Stout John R. Evans and Company, Camden, New Jersey.	1	1943
Harry L. Cannon President, H. P. Cannon & Son, Inc., Bridgeville, Delaware.	2	1941
Ward D. Kerlin Secretary and Treasurer, Camden Forge Company, Camden, New Jersey.	3	1942
Class C:		
Thomas B. McCabe, Chairman and Federal Reserve Agent.. President, Scott Paper Company, Chester, Pennsylvania.		1942
Alfred H. Williams, Deputy Chairman Dean, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia.		1941
Warren F. Whittier Lonicera Farms, Douglassville, Pennsylvania.		1943

Officers

JOHN S. SINCLAIR, *President*

FRANK J. DRINNEN,
First Vice President

L. E. DONALDSON,
Assistant Vice President

C. A. McILHENNY,
Vice President and Cashier

C. A. SIENKIEWICZ,
Assistant Vice President

W. J. DAVIS,
Vice President

JOHN McDOWELL,
Assistant Vice President

ERNEST C. HILL,
Vice President

JAMES M. TOY,
Assistant Cashier

WILLIAM G. MCCREEDY,
Assistant Vice President

ARTHUR E. POST,
Secretary

PHILIP M. POORMAN, *Auditor*