BANKING TRENDS AND PROSPECTS

Twenty-ninth Annual Report

of the

FEDERAL RESERVE BANK

OF PHILADELPHIA

1943

Third Federal Reserve District

CONTENTS

FEDERAL RESERVE BANK
OF PHILADELPHIA

April 30, 1944.

To the Member Banks in the
Third Federal Reserve District:

There is presented in this Twenty-ninth Annual Report of the Federal Reserve Bank of Philadelphia a review of major banking and business trends and developments in the Third Federal Reserve District.

ALFRED H. WILLIAMS
President.

BANKING, CREDIT, AND FINANCE

Each of the many units that comprise the American banking system must adapt its policy and program to its own problems. For the system is strong only as each of its units is strong; the strength of one cannot offset the weakness of another. Yet there is no grand, simple, universal plan suitable without modifications to all banks. Each bank is compelled to analyze both general and local developments if it is to provide leadership in its community in the difficult periods ahead.

The outstanding general development of the past year has been further integration of banks into the war effort. This conversion to agencies of war finance is reflected clearly in the record-breaking increase in holdings of Government securities by members in this district from $1,841 million on December 31, 1942 to $2,764 million a year later, and the resulting increase from $4,145 million to $4,831 million in deposits. The importance of local conditions to individual banks is shown by the fact that although the rate of increase in deposits at all banks in the district in the four years ended June 1943 was 45 per cent, the rates for individual counties varied from 8 per cent to 91 per cent.

Role of the Third District in war finance

Purchases of securities by commercial banks and others in the Third Federal Reserve District, shown in the table on the next page, give a rough measure of the participation of the district in the war borrowing program of the Treasury.

The success of efforts to sell as many securities as possible to nonbank investors is indicated by the fact that in this district they bought $335 million of securities in the First War Loan Drive,

Allotments on Cash Offerings of Treasury Securities

Third Federal Reserve District

(Millions $)	Date	Commercial banks	Nonbank investors	Total	% of United States
1943					
Special issues					
Bonds:					
2 %	April 15	137.5	123.2	260.6	5.3%
2½%	April 15	0	200.7	200.7	5.3
2 %	Sept. 15	0	213.2	213.2	4.1
2½%	Sept. 15	0	207.4	207.4	5.5
2 % (additional)	Oct. 15	112.4	0	112.4	6.9
Notes:					
1½%	July 12	97.3	38.1	135.4	5.0
Cert. of indebt.:					
⅞%	Feb. 1	47.0	25.9	72.8	3.3
⅞%	April 15	94.7	101.7	196.4	3.7
⅞%	Aug. 2	56.6	0	56.6	5.7
⅞%	Sept. 15	0	171.4	171.4	4.2
⅞%	Oct. 15	91.3	0	91.3	5.8
Total special		636.6	1,081.7	1,718.4	4.7%
Continuous issues					
Bills		1,722.3	..	1,722.3	3.6%
Tax and savings notes		..	463.3	463.3	5.8
Savings bonds: E		0	491.9*	491.9*	4.8
F		0	43.0	43.0	5.8
G		0	171.7	171.7	6.5
Total continuous		1,722.3	1,170.0	2,892.3	4.2%
Grand total, 1943		**2,359.0**	**2,251.7**	**4,610.7**	**4.4%**
1944: First two months					
Special issues					
Bonds:					
2¼%	Feb. 1	39.4	232.3	271.7	7.3%
2½%	Feb. 1	6.5	85.9	92.4	4.2
Cert. of indebt.:					
⅞%	Feb. 1	0	164.7	164.7	3.3
Total special		45.9	482.8	528.8	4.8%
Continuous issues					
Bills		217.7	0	217.7	2.7%
Savings notes		..	122.3	122.3	5.5
Savings Bonds: E		0	139.6*	139.6*	4.4
F		4.7	12.4	17.1	6.0
G		19.5	51.1	70.5	7.0
Total continuous		241.9	325.3	567.2	3.8%
Grand total, 1944, 2 months		**287.8**	**808.1**	**1,096.0**	**4.3%**

* Does not include postoffice sales or those by certain Army and Navy establishments.
Note: Interdistrict allocations omitted.

$659 million in the Second, and $934 million in the Third, and $855 million in the Fourth. Approximately 3½ million Series E bonds were sold in the Third Drive in addition to 75,000 other sales to nonbank investors. The corresponding figures for the Fourth Drive were over 4½ million and 76,300.

Banks played an important part in achieving these results. With each successive war loan drive, they intensified their efforts to siphon surplus spendable funds into Government securities. Their officers, directors, and key men have served as chairmen, members, and solicitors of regional and local committees organized to sell new issues to individuals, business concerns, and institutional investors. About four-fifths of the securities sold in Pennsylvania during the Third Drive were sold through the efforts of banks.

Purchases of Government securities by individuals and business institutions do not result in permanent withdrawals of deposits from the banking system. The complete cycle of Treasury financing through nonbank investors is roughly as follows: A bank effects payment for its customer by transferring funds from the account of the customer to the War Loan Account of the Treasury. When the Treasury pays its bills, the deposits are withdrawn from the War Loan Account and are returned to private accounts. Individual banks share to different degrees in the various phases of this process, but most of the deposits never leave the banking system.

Although the net effect is the same, the process in general is slightly more complicated for any single Federal Reserve District. For example, the Treasury usually raises more funds in this district than it spends here; but, as is shown in the table on page 6, the loss of funds resulting from Treasury operations is more than offset by commercial transfers of funds to this district, including those that arise indirectly from Treasury operations. Inter-relations between Treasury operations and commercial transfers may be visualized by means of the following example. The Treasury uses funds, part of which were borrowed in this district, to pay a prime contractor in another district for final products delivered under a war contract. The prime contractor in turn uses part of these funds to pay a subcontractor in this district for raw materials and parts that were purchased to complete the contract. Although the Treasury operation transfers funds out of the district, it gives rise to a commercial transfer into the district.

Federal Reserve policy

The primary objectives of the Federal Reserve System have been to assure that the war effort will not be impeded because of inadequate funds, to insure relative stability in the money market, and to restrict the creation of purchasing power to the minimum consonant with financing the war.

Policies initiated earlier to keep the volume of credit to a minimum were continued in 1943. Among the more important of these are intensified efforts to sell Government securities to nonbank investors, restrictions of consumer credit through Regulation W, and reductions—encouraged through banks and bank examiners—in the volume of nonessential loans.

The Reserve System has adopted a number of measures to enable banks to acquire such Government securities as they are expected to purchase. Some of these measures were undertaken to encourage banks to utilize available reserves as fully as possible, others to offset losses resulting from currency demand and other factors.

Banks have been encouraged to utilize their reserves to the full by repeated statements that the Reserve System has, and is prepared to use its powers to assure that an ample supply of funds is available at all times for financing the war effort. In an announcement on November 22, 1942, bank supervisory agencies stated that banks will not be criticised for investing their idle funds as far as possible in Government securities. To dissipate the effects of fears that a return flow of funds would not materialize banks have been assured of ready access to the Reserve Banks and that they will not be criticised for "availing themselves of the privilege of temporarily borrowing from or selling Treasury bills to the Federal Reserve Banks when necessary to restore their required reserve positions."

Reserve Banks stand ready to purchase all Treasury bills offered at three-eighths per cent and grant the seller the option of repurchase at the same rate. As a consequence, Treasury bills are virtually as liquid as excess reserves, and member banks may keep fully invested. Purchases of Treasury bills were the most important method of extending credit in this district. The volume held by this Bank varied between $2 million and $281 million. The Bank also continued the low rates at which it rediscounts and makes advances. The regular rate is one per cent and that on advances secured by United States Government obligations with one year or less to call or maturity is only one-half per cent.

Thus far, the Reserve System has found it necessary to extend credit chiefly to offset the increase in currency demand. The increase in reserve requirements resulting from rapidly increasing deposits has been less than the volume of excess reserves with which member banks entered the war. Indeed, the past year witnessed a small further decline in reserve balances. The extent to which banks have utilized their reserves over the past few years is shown in the accompanying table.

Member bank reserves Third Federal Reserve District (Dollar figures in millions)	Actually held	Required	Excess	Ratio of excess to required
Philadelphia banks:				
1941: Jan. 1-15	$514	$232	$282	122%
1942: Jan. 1-15	449	294	155	53
1943: Jan. 1-15	418	358	60	17
1944: Jan. 1-15	370	357	13	4
Country banks:				
1941: Jan. 1-15	202	103	98	95
1942: Jan. 1-15	224	145	79	55
1943: Jan. 1-15	256	184	72	39
1944: Jan. 1-15	272	215	57	26
All members:				
1941: Jan. 1-15	716	335	380	113
1942: Jan. 1-15	673	439	234	53
1943: Jan. 1-15	674	542	132	24
1944: Jan. 1-15	642	572	70	12

In addition to legal reserves, member banks in Philadelphia early in 1944 held $72 million and country members held $180 million of balances due from other banks. These amounts were equal to 20 per cent and 84 per cent respectively of required reserves at the two groups of institutions.

Bank purchases of Government securities result in corresponding increases in bank deposits. As a result, banks were subjected to temporary strains upon reserve positions when they made heavy purchases of Government securities. Relief from such strains was accomplished in April 1943 when the Federal Reserve Act was amended to eliminate reserve requirements against war loan deposits. In effect, this amendment deferred the need for reserves from the time securities were bought to the time the Treasury spent the funds.

The big independent factor that has absorbed reserves and has brought the market into the Reserve Banks has been the continued increase in currency demand, which in this district amounted to $305 million in the year 1943. The increase in circulation absorbed not only the net gain in funds resulting from the excess of interdistrict transfers over Treasury operations but over $200 million of Reserve Bank credit as well. The details of factors affecting member bank reserves in this district in the past three years are given in the accompanying table.

Changes in member bank reserves and related items Third Federal Reserve District (Millions of dollars)	1941	1942	1943
Sources of funds:			
Reserve Bank credit extended in district	— 7	+ 39	+210
Interdistrict commercial transfers	+484	+876	+846
Mint gold purchases, net	+ 3	+ 2	+ 0
Treasury operations	—368	—659	—755
Total	+112	+258	+301
Uses of funds:			
Currency demand	+168	+280	+305
Member bank reserve deposits	— 42	— 10	— 6
"Other deposits" at Reserve Bank	— 14	— 8	+ 1
Other Federal Reserve accounts	— 0	— 4	+ 1
Total	+112	+258	+301

Banking trends

Member bank trends continued to be influenced by the same forces as in the preceding year. Unlike the financial impact of the First World War, which resulted principally in sharply expanded loans to war industries and to customers to finance the purchase of Government securities, the major active force in present war finance is exerted through direct bank purchases of Treasury securities. Total loans at all member banks in this district, which increased by about 20 per cent from 1938 to our entry into the conflict, have decreased continuously since, except for temporary interruptions during the war loan drives. The decline was halted at Philadelphia members during the past year but continued at country members. Investments other than Governments also have been reduced. Banks have utilized the opportunities afforded by relatively active markets to dispose of real estate assets. The net increase in assets has been accompanied by an approximately equivalent increase in deposits, since capital accounts were enlarged only in relatively negligible amounts.

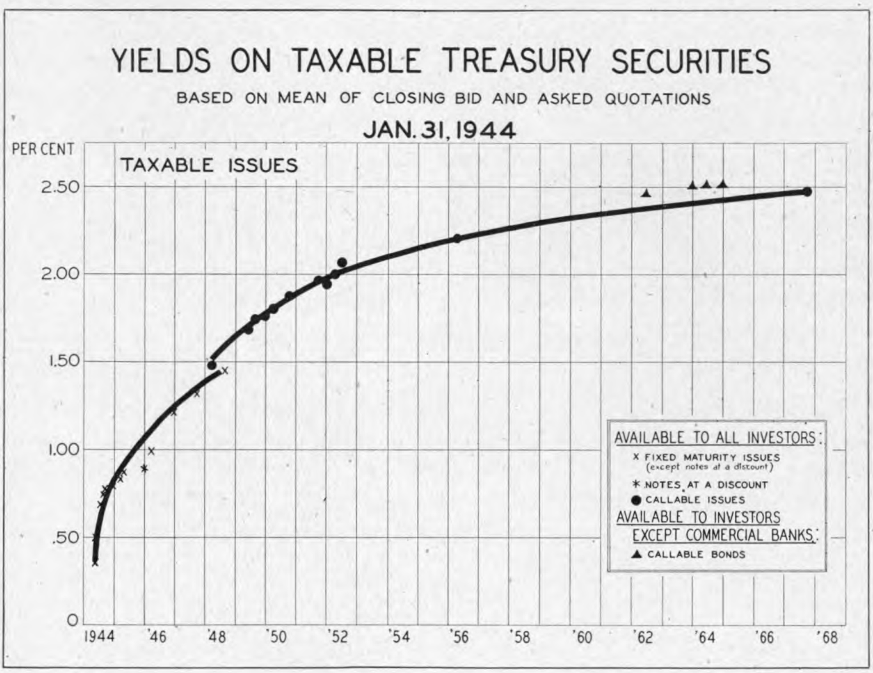
The position of the major accounts and the changes since strategic dates are shown in the table. October 2, 1939, was just after the outbreak of war in Europe; June 30, 1940, may be taken as the beginning of our preparedness; December 1941 marks our entry into the conflict; and December 1942 was shortly after the inauguration of what has been called aggressive deployment.

Member banks Third Federal Reserve District (Dollar figures in millions)	Dec. 31, 1943	Per cent change from			
		Dec. 31, 1942	Dec. 31, 1941	June 29, 1940	Oct. 2, 1939
Resources:					
Loans	$ 852	— 8	— 24	— 14	— 8
U. S. Gov't obligations	2,764	+50	+168	+270	+261
Other securities	427	—18	— 25	— 30	— 33
Cash assets*	1,167	— 4	— 12	— 5	+ 6
Real estate assets	106	—15	— 23	— 32	— 39
Other	24	+33	+ 14	+ 14	— 4
Total	$5,340	+15	+ 27	+ 42	+ 47
Liabilities and capital accounts:					
Deposits*	$4,830	+17	+ 30	+ 49	+ 55
Other liabilities	19	—10	— 14	— 10	+ 6
Capital accounts	491	+ 2	+ 2	+ 2	— 1
Total	$5,340	+15	+ 27	+ 42	+ 47

* Includes reciprocal bank balances prior to December 1942.

Government securities Government securities now make up well over half of the assets of member banks in this district. From a purely quantitative point of view the increase of bank holdings of Government securities measures the extent to which the Treasury has not secured needed funds from other sources. Although banks have secured the funds to a limited extent from reductions in other earning assets, for the most part the increased holdings have resulted in larger deposits.

When all banks maintain a fully invested position, the participation of an area such as the Third Federal Reserve District in the total expansion depends upon its general position in the whole economy—just as under such conditions the expansion of a single bank depends upon its position in the community. As banks have become more uniform in following policies of substantially full investment, they have shifted their emphasis from amount to types of securities they acquire.



Banks are limited, of course, both by the amount of certain types available and with respect to the issues they may purchase. Still important but destined to disappear are the partially tax-exempt issues. Of publicly marketable issues outstanding, such securities made up three-fourths on December 31, 1941, two-fifths a year later, and only one-fourth on December 31, 1943. The relative decline resulted both from increases in total issues and absolute decreases in tax-exempts. Since they held Government securities long before exemption privileges were removed from new issues, banks always have held considerable amounts of tax-exempts. For years, however, their earnings and income tax positions were such that they gained very little from the exemption features. The improved income prospects at many banks directed attention to the privileges of such issues. During the past year, particularly in the first quarter, banks in certain areas purchased tax-exempts in considerable volume, especially those of long maturities, as insurance companies sold. Banks in this district, however, did not increase their total holdings of such securities although there was some shifting from intermediate to long maturities.

The primary differences among Government securities are those with respect to maturities and the correlative differences in yields. The relationships between the two as of January 31, 1944, are shown in the chart.

Major influences that have affected the maturity distribution of member bank portfolios of Government securities over the past two years have been the gradual spread of the policy of substantially full investment—as contrasted with the policy of maintaining large excess reserves—the changes in maturity composition of outstanding issues, and changes in issues available for bank purchase. The maturity compositions of outstanding marketable Government securities and of those held by over 550 banks including savings banks in this district are shown in the table on the next page.

At the end of 1941 outstanding marketable issues of Government securities were about equally divided between those maturing

Maturities of marketable Government securities (Dollar amounts in millions)	December 31, 1943			December 31, 1941		
	Outstanding — United States	Held by banks in Third Federal Reserve District		Outstanding — United States	Held by banks in Third Federal Reserve District	
		Philadelphia	Country		Philadelphia	Country
Bills	$ 13,072	$ 82	$ 142	$2,002	$ 10	$ 15
Certificates	22,843	349	239	—	—	—
Other under 1 year	6,916	76	61	3,239	45	48
Total	$ 42,831	$ 507	$ 442	$ 5,241	$ 55	$ 63
1-5 years	22,940	323	373	17,708	210	173
5-10 years	30,015	674	576	12,318	235	154
Over 10 years	23,464	328	225	12,612	265	169
	$119,250	$1,832	$1,616	$47,878	$767	$559
	Percentages					
Bills	11%	5%	9%	4%	1%	3%
Certificates	19	19	15	—	—	—
Other under 1 year	6	4	3	7	6	8
Total	36%	28%	27%	11%	7%	11%
1-5 years	19	17	23	37	27	31
5-10 years	25	37	36	26	31	28
Over 10 years	20	18	14	26	35	30
	100%	100%	100%	100%	100%	100%

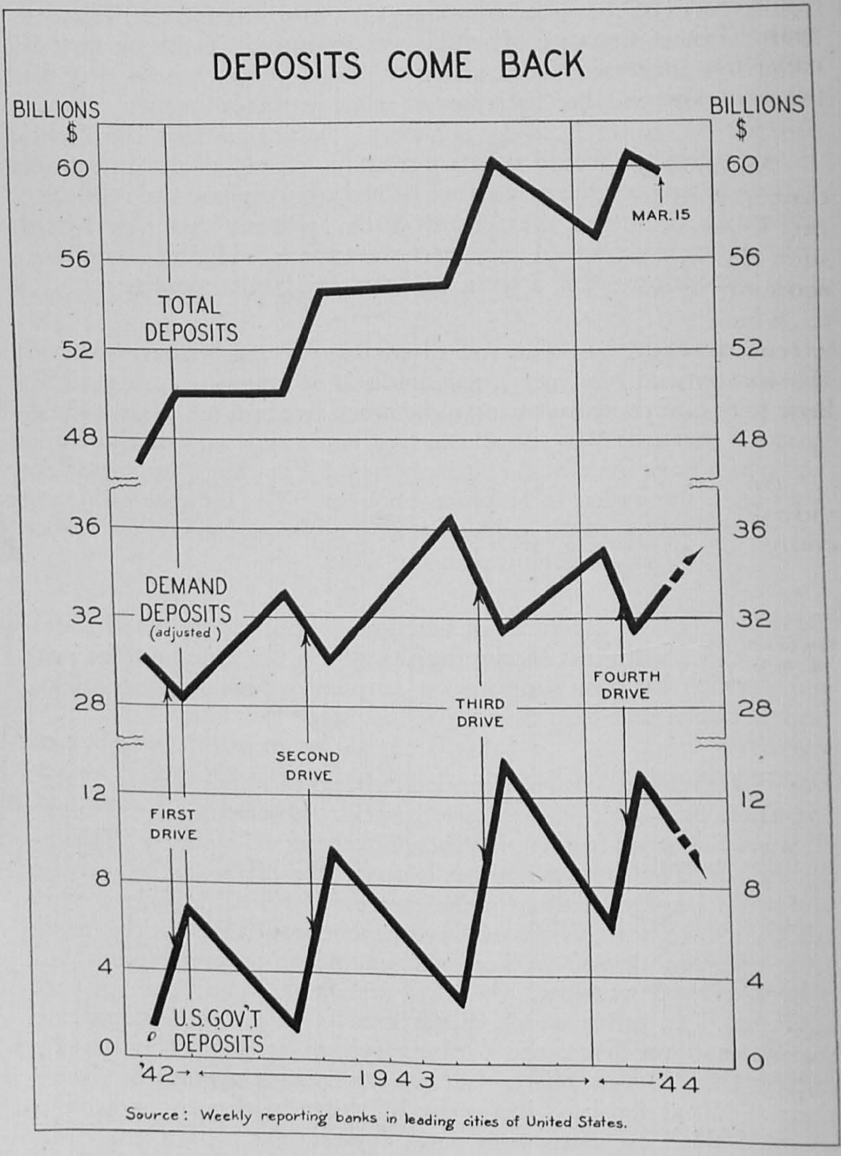
within five years and those maturing after five years; the longer issues in turn were about equally divided between those maturing within five to ten years and those maturing after ten years. At that time banks in this district held comparatively larger proportions of long-term issues, especially those maturing after ten years. The apparent policy of banks was to maintain primary reserves at levels sufficient to provide liberally for all possible cash needs and to invest the remaining funds in long-term and higher-yielding securities. In part this was a result of the abnormal conditions of the preceding decade when the usual secondary reserves—call loans, banker's acceptances, etc.—had almost disappeared, when yields on those that remained fell to negligible amounts, and when banks became habituated to very large excess reserves.

These underlying conditions changed markedly in the ensuing two years. The Treasury brought out much larger proportions of the rapidly increasing total volume of Government securities in the form of short-term issues—Treasury bills and certificates of indebtedness, issuance of which was resumed. Yields on new bill offerings increased from about 1/20 per cent, where they had been prior to the increase in reserve requirements effective November 1, 1941, to ⅜ per cent. Assurance that the Federal Reserve System would use its powers to supply at all times ample funds to finance the war effort helped to overcome the reluctance of banks to invest their funds fully. Finally new issues with maturities in excess of ten years were made ineligible—with certain exceptions—for a term of years for bank investment.

As a result, banks in this district have greatly increased both absolutely and relatively their holdings of issues maturing within one year and those maturing in between five and ten years. Holdings of maturities in the one to five year range and of those over ten years have decreased relatively to total holdings but have been increased somewhat in absolute amounts. The increase in longest term issues is a result primarily of purchases by savings banks, whose holdings are included in the table.

Deposits The dynamics of wartime deposit creation and distribution is shown graphically in the chart on the next page which has been simplified to emphasize developments during and between war loan drives.

The Treasury conducts periodic drives to obtain funds. During these drives individuals pay for their subscriptions, and funds flow out of private accounts into Government deposits. The increase in Treasury accounts exceeds the decrease in private accounts largely because banks create additional deposits to pay for their own acquisitions of Government securities. In the intervals between drives, as Treasury payments to contractors and others exceed receipts, the deposits again flow into private accounts. In other words, funds used to purchase Government securities never leave the banking system at all, except to the extent that currency is withdrawn or foreign operations absorb them. What happens is a series of shifts in deposit ownership coupled with an increase in total deposits resulting from bank purchases.


DEPOSITS COME BACK
BILLIONS $
60
56
52
48
36
32
28
12
8
4
0
TOTAL DEPOSITS
MAR. 15
DEMAND DEPOSITS (adjusted)
FIRST DRIVE
SECOND DRIVE
THIRD DRIVE
FOURTH DRIVE
U.S. GOV'T DEPOSITS
'42
1943
'44
Source: Weekly reporting banks in leading cities of United States.

At member banks in the Third Federal Reserve District deposits expanded by a larger amount in 1943 than in any previous year. Total deposits increased $686 million or 17 per cent. Expansion at all member banks in the United States amounted to 18 per cent during the same period.

An obvious essential in the development of sound policies by central banking authorities as well as by individual banks is accurate knowledge of the ownership of deposits. To the central bank such information indicates such factors as the areas in the economy which may be subjected to greatest pressures, the extent to which industries may be able to finance themselves, or the extent to which they may need funds. To the management of the individual bank the information is valuable in determining how it fits into the whole economy and something of its prospects.

An analysis of the ownership of demand deposits of individuals, partnerships, and corporations in this district and in the country is given in the following summary table.

Ownership of demand deposits of individuals, partnerships, and corporations (Revised estimates as of July 31, 1943)	Third F. R. District		United States		% District of United States
	Amount (Million $)	% of total	Amount (Billion $)	% of total	
Domestic business:					
Nonfinancial—					
Manufacturing and mining...	749	25.2%	16.4	29.6%	4.6%
Public utilities, transportation, etc.	257	8.6	3.7	6.6	6.9
Trade	369	12.4	7.7	13.9	4.8
Other nonfinancial	180	6.0	3.2	5.7	5.6
Total nonfinancial	1,554	52.2%	31.0	55.8%	5.0%
Financial (insurance, trust funds, etc.)	393	13.3	5.8	10.5	6.8
Total domestic business..........	1,946	65.5%	36.8	66.3%	5.3%
Nonprofit organizations	88	2.9	1.4	2.5	6.3
Personal (incl. farmers).........	940	31.6	16.4	29.5	5.7
Foreign	...	...	.9	1.7	...
Grand total	**2,974**	**100.0%**	**55.6**	**100.0%**	**5.3%**

Loans Changes in the total volume and in the character of loans have reflected the adjustment of member banks in this district to wartime conditions. After remaining comparatively stable for several years, total loans began to expand with the outbreak of war in Europe. The increases were greater both absolutely and relatively to total loans at member banks in Philadelphia than at country members. The principal increases in Philadelphia were in loans to trade and industry, where larger inventories and generally more active business expanded the requirements for working capital, and in miscellaneous advances to finance consumer purchases. At country banks the principal increase was in loans extended for the purchase of real estate and for construction and renovation of buildings.

Total loans ceased to increase with the entry of this country into the war. The appropriate loan policy then became to extend only credit needed by activities related to the war and to reduce credit extended to nonessential activities. Total loans declined because many of the initial demands to finance war industries had been met and additional loans to them did not offset reduced credit requirements in civilian activities.

At country member banks declines were greater and were still in progress at the end of the year as compared with Philadelphia members where the second half of the past year witnessed some recovery in volume. The changed character of loans was revealed in an analysis made in the spring of 1942 when loans wholly or partly to finance war industry accounted for 44 per cent of new loans made to industry and commerce.

Capital funds Capital funds alone of the major banking accounts have remained virtually constant over the past decade. As a result, the ratio of capital accounts to deposits has declined as deposits have increased. The adequacy of capital, of course, is not measured by this simple ratio. In the final analysis the solvency of a bank depends upon the quantity and quality of the assets relative to its liabilities. The past year has seen not only a great increase in the amount of assets and liabilities but also marked improvement in the average quality of assets. The improvement in quality has come both because new assets have been mostly Government securities and because there has been a significant decrease in lower-grade assets, especially real estate. The improvement is indicated in the fact that at the end of 1943 cash assets plus Government securities were equal to 81 per cent of total deposits as compared with 74 per cent at the close of 1942 and about 28 per cent in the years 1927-1929.

Earnings and expenses

The simple statement that total current earnings of member banks in this district increased 3 per cent to \$110.6 million, though true, gives an inadequate impression of the significant developments in earnings and their disposition. The small change is the net result of important but largely offsetting changes in the amount, character, and extent of utilization of assets. Thus, total assets increased 15 per cent and cash assets were reduced 4 per cent. Even more important, however, was the shift from loans and from other investments to Government securities. As a result, income from investments increased 21 per cent to \$53.3 million and more than offset the decline of 17 per cent to \$35.2 million in income from loans. Government securities were the most important source of income.

The increase in net profits from \$18.0 million in 1942 to \$30.5 million in 1943—the largest amount since 1929—was in sharp contrast to the small increase in total current earnings. Most of the increase was accounted for by reductions of two-thirds in net charge-offs. The smallest net charge-offs in many years indicate the marked improvement in the quality of assets that banks have been effecting in recent years through disposition and markdowns of lower-grade assets. Member banks as a whole have not utilized the larger net profits to increase dividends but have retained them to afford additional protection required by their larger asset positions and the necessity of assuming risks in the post-war period.

Member banks Third Federal Reserve District (Dollar amounts in millions)	1942	1943	Per cent change
Current earnings:			
On investments	$ 44.0	$ 53.3	+21
On loans	42.3	35.2	—17
Trust department	9.7	10.4	+ 7
Service charges on deposits	3.2	3.3	+ 3
Other	8.6	8.4	— 2
Total	**$107.8**	**$110.6**	**+ 3**
Current expenses:			
Salaries and wages	$ 30.2	$ 30.9	+ 2
Interest on deposits	10.6	9.7	— 8
Other*	33.9	34.7	+ 2
Total	**$74.7**	**$75.3**	**+ 1**
Net current earnings	**$33.1**	**$35.3**	**+ 7**
Net charge-offs	$ 15.1	$ 4.8	—68
Net profits	**$18.0**	**$30.5**	**+69**
Cash dividends declared	$ 15.9	$ 15.8	— 0

* Includes taxes.

Rates on commercial loans by banks in Philadelphia, which increased slowly but persistently for about three years until mid-1943, declined slightly in the last half of the year to the level in effect at the end of 1940. Analysis of the accompanying table indicates that the average decline, though small, is significant because reductions were general throughout the range of rates. Although loans continued to concentrate at rates between 2 and 3 per cent, only 44 per cent of volume was at higher rates in December as compared with 58 per cent in June. On the other hand, 20 per cent of loans were made at lower rates in December as contrasted with only 9 per cent in June.

Prospects Banks continue to adjust themselves to rapid changes in national and local environment. Except for the fact of change itself, much that lies ahead is uncertain. But though uncertainty increases the difficulties, aggressive banks

Rates on commercial and industrial loans made by seven Philadelphia banks (000's omitted in $)	Dec. 1-15, 1941	Dec. 1-15, 1942	June 1-15, 1943	Dec. 1-15, 1943
Less than 1 per cent	$ 0	$ 0	$ 0	$ 38
1 per cent	1,247	813	17	110
Between 1 and 1½ per cent	730	500	0	1,025
1½ per cent	5,748	3,460	1,909	5,613
Between 1½ and 2 per cent	874	1,250	300	200
2 per cent	1,942	1,865	1,720	1,903
Between 2 and 3 per cent	2,611	7,832	13,618	16,429
3 per cent	4,266	6,255	5,874	8,866
Between 3 and 4 per cent	2,563	2,821	6,831	4,647
4 per cent	3,723	2,640	8,462	3,854
Between 4 and 5 per cent	1,882	1,814	1,064	799
5 per cent	1,475	2,058	1,217	1,314
Between 5 and 6 per cent	139	538	49	21
6 per cent	956	721	553	381
Total dollar amount	**$28,156**	**$32,567**	**$41,614**	**$45,200**
Total number of loans	**1,336**	**894**	**704**	**741**
Average rate based on dollar volume	2.9%	3.0%	3.1%	2.8%

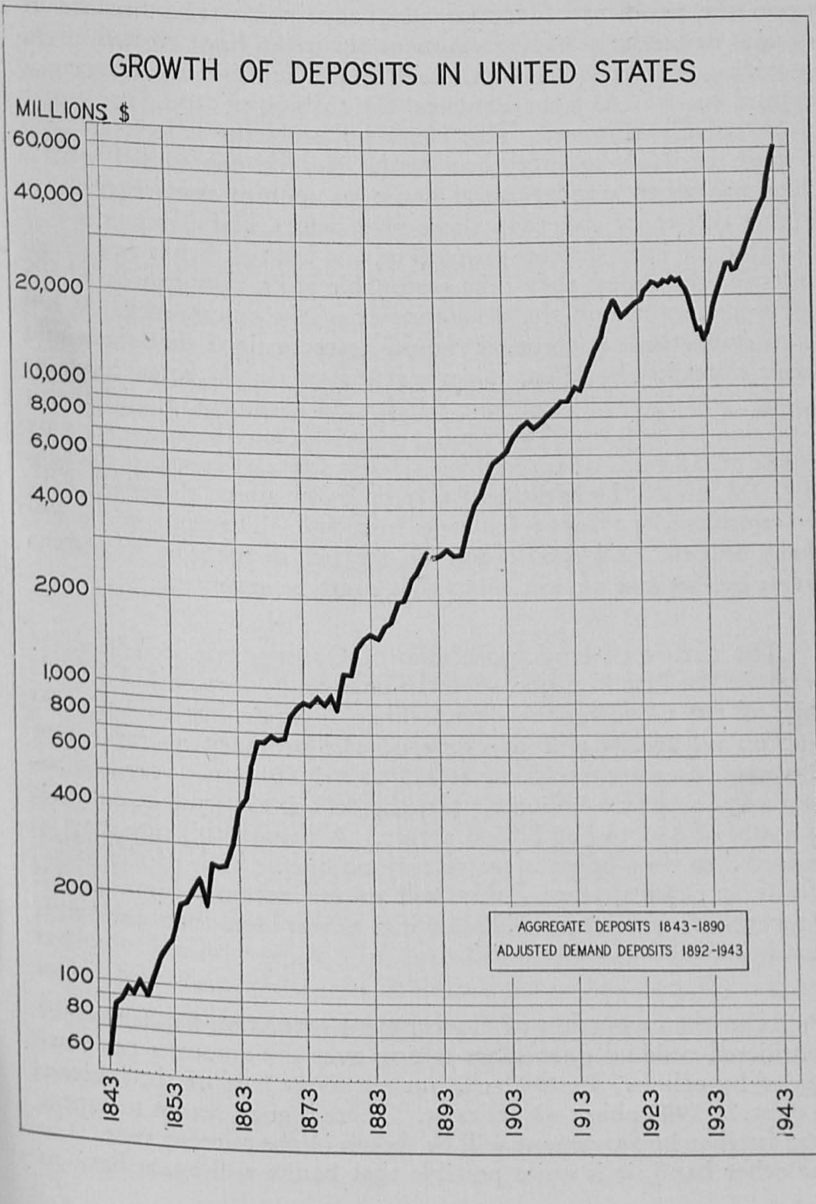
never have permitted it to halt the development of positive policies and programs. Uncertainty calls for flexible policies, not for the abandonment of policy formulation.

Wartime credit experiences underscore the fact that individual banks are affected by national and by local developments. The management of a bank can divide its problems of looking ahead into those affecting the entire banking system and those affecting the position of its own bank in the system. The system as a whole, of course, will purchase the amount of Government securities it is expected to take and will create sufficient deposits to do so. The amount and type of securities that the individual bank should take depend primarily upon the proportion of these deposits that it holds and will hold.

Interest centers upon the future of four major balance sheet accounts: deposits, loans, investments, and capital. At the national level, total deposits have increased phenomenally during the war, and it is virtually certain that they are on a permanently higher level. As is shown in the chart on page 19, only once in the past century—during the Great Depression of the 1930's—have demand deposits declined as long as two years in succession. Further expansion from present levels is in prospect during the war to the extent that Government fiscal requirements are met through direct absorption of Government securities by commercial banks or indirectly by increases in bank credit to facilitate the distribution of these securities to other investors.

The trend of deposits after the war will depend largely on the extent to which Government debt is in the hands of the banks and on the future of bank loans. Even a decline in gross debt would not necessarily result in smaller Government security holdings by banks since redemptions by the public might result in still larger bank portfolios with accompanying increases in deposits. It is obvious that the country will enter the post-war period with a volume of deposits far in excess of the pre-war volume; and there is little likelihood that deposits will decline below present levels in the immediate post-war period.

Lending where justified is one of the basic functions of a commercial bank. One need only glance at balance sheets to see that banks have been losing loan business to other agencies for a considerable period of time. The national future of bank loans depends upon the policies that banks adopt. There seems little likelihood of any great revival in traditional commercial loans. It should not occasion surprise that customary forms of credit instruments and traditional rules of thumb are no longer adequate. It is anticipated that national income in the post-war period will be at levels considerably above those achieved before the war. If these goals are realized, it seems likely that there will be considerable demands for credit. The extent to which banks will participate in the extension of this credit will depend upon their ability to adjust their credit facilities to the requirements of the general public.


GROWTH OF DEPOSITS IN UNITED STATES
MILLIONS $
60,000
40,000
20,000
10,000
8,000
6,000
4,000
2,000
1,000
800
600
400
200
100
80
60
AGGREGATE DEPOSITS 1843-1890
ADJUSTED DEMAND DEPOSITS 1892-1943
1843
1853
1863
1873
1883
1893
1903
1913
1923
1933
1943

Consideration of post-war loan possibilities focuses attention upon the problem of capital adequacy which arises because increases in holdings of Government securities have created corresponding increases in deposits without substantial increases in capital funds. As a consequence, the cushion of capital has grown progressively thinner. This raises no problems as long as assets remain of high quality, but banks will be confronted with a dilemma when opportunities come to acquire assets carrying a higher degree of risk than those now held. The dilemma is that the thinner their capital protection, the less risk banks can afford to take, but unless they take reasonable risks, they cannot play a very positive role in the development of the community. When such opportunities come, it should be recognized that the rate a bank charges when it acquires a risk asset should be adequate to cover both interest on the funds and payment for the risk assumed. Yields on Government securities may be taken roughly as the going rates of interest on riskless assets of specified maturities. Much of the additional rate on other assets, therefore, may be considered payment for risks assumed. That portion is not really income and should not be treated as such; it should be treated as reserve against losses that must be expected.

The future of bank portfolios of Government securities depends in the first instance upon the changes in the size and ownership of the Government debt. Since expenditures to fight the war on all fronts and to carry on the ordinary operations of Government were estimated at $95 to $100 billion a year and receipts at forty odd billion a year, the debt is expected to increase at a rate of $55 to $60 billion a year. Although this rate may be expected to slow down after victory on one or both of the major fronts, expenditures probably will exceed receipts for a period after the final victory. Financing a war does not end with hostilities.

As to the ownership of Government securities, banks may be considered residual purchasers taking over the amounts not purchased by others. In 1942 this meant about half of the increase in debt, in 1943 about 43 per cent. There is good reason to expect that further improvement will be shown in the current year. On the other hand, it is quite possible that banks will again have to step into the breach if present owners liquidate any considerable amount of securities after the war. For the banking system as a whole, therefore, it appears that holdings of Government securities will increase even after the war though at a much slower rate than in 1943. The chief reason for the increase during the remainder of the war will be the increase in total debt; the chief reason after the war may be liquidation by other holders.

Although national prospects are the most important, they are not the only factors influencing developments at individual banks. Local factors also are significant. For example, although demand deposits of individuals and business concerns increased generally over the country between 1939 and 1943, they tripled at member banks in the San Francisco Federal Reserve District, doubled in the Philadelphia District, and increased to only one and three-quarter times in the New York District. Large shifts among areas may occur when deposits cease to grow as rapidly as they have recently. Some banks—especially those in areas gaining exceptionally from war activities—may lose deposits; but since total deposits probably will be permanently higher than before or than they are today, other banks will gain.

Obviously a bank cannot predict precisely what its own future may be. At the same time, it cannot develop sound policies without an informed opinion as to its future position. Careful estimates involve much hard work, but the rewards for accuracy are great. Flexibility demands that any estimate be subject to revision as conditions change and as new information becomes available.

Bankers who are looking ahead objectively for their own institutions are asking many fundamental questions. Among them are the following:

1. Is my bank sharing in the current growth of deposits?
2. What shifts have taken place and are likely to take place in the volume of deposits at my bank?
3. Does the investment policy of my bank show effective use of the available funds?

4. Is the management of my bank surveying and stimulating the lending field in my community?
5. Are the loan facilities of my bank geared to meet the potential demands for loans?
6. Is the capital position of my bank adequate to assume risks in developing business in my community?
7. What is the current and prospective earning position of my bank?

These questions are crucial, the answers difficult, but upon the quality of answers depends the effectiveness of the program of the individual bank. The function of the management is to develop flexible policies and programs appropriate—on the basis of the best information available—to present and anticipated conditions. The problem may be reduced to manageable proportions by estimating the effects of all important influences upon the balance sheet of the bank.

Although each bank must adopt a procedure to suit its own circumstances, a number of bankers have found a common approach useful in formulating policies for their own institutions. All accounts should be analyzed in formulating policies; but the procedures employed may be illustrated by application only to three major accounts—deposits, loans, and Government securities.

1. *Deposits.* It is a common observation that most banks expand and contract in unison and that changes in deposits at most banks are closely related to changes in total deposits in the area and in the country as a whole. Work Sheet 1, reproduced on page 23, has been constructed to enable a bank to ascertain the position it has achieved in the system. The proportion that deposits at any bank bear to total deposits is, of course, usually very small; but changes in this proportion are of great importance. For example, if the proportion has remained stable over the years, it signifies that the bank is fully integrated into the system and that the primary influence on its position is what happens to total deposits of the system. A regularly increasing ratio indi-

Work Sheet 1

Over-All Deposit Analysis

(Dollar amounts in millions)

December 31	Total deposits—member banks		Total deposits my bank	Proportion my bank to	
	United States	3rd District		United States	3rd District
1925	$34,250	$2,300		%	%
1926	34,528	2,386			
1927	36,657	2,469			
1928	39,067	2,488			
1929	37,981	2,468			
1930	37,029	2,578			
1931	30,711	2,263			
1932	28,690	2,209			
1933	27,167	2,008			
1934	33,848	2,382			
1935	38,454	2,629			
1936	42,885	2,935			
1937	40,839	2,750			
1938	43,363	2,861			
1939	49,340	3,231			
1940	56,430	3,452			
1941	61,717	3,704			
1942	78,277	4,145			
1943	92,262	4,830			
1944 (est.)					
1945 (est.)					

cates that the bank is growing more rapidly than the average and a regularly declining ratio that it is growing less rapidly. The management may wish to ascertain the reason for and the prospective permanence of the differences in developments at its own bank and at other banks. In attempting to make a preliminary estimate of its prospective deposits the management may apply its own prospective ratio based upon experience to prospective total deposits, remembering that this total is unlikely to fall from present levels and may continue to rise.

The preliminary estimate based upon prospective national developments should be adjusted for local factors. Just as the uneven stimulation given by the development of war industries and military centers has resulted in uneven distribution of deposits, so shifts of deposits after the war are to be expected. For the individual banker the important thing is to analyze the position of his community in the post-war world. His community will tend to gain deposits as its businesses and individuals sell their products and services outside and will tend to lose deposits as they buy elsewhere. The community's net position will be influenced by such factors as changes in population and working force, the adaptability of local productive facilities to the satisfaction of post-war demands, the expenditures of inhabitants, especially for durable consumer goods, and the needs of business establishments for reconversion and placing operations on a peacetime basis.

A helpful tool in estimating allowances that should be made for these local factors is an analysis of the ownership of deposits which could be based on the information indicated in Work Sheet 2 on page 25. Results for an individual bank can profitably be compared with district and national totals published from time to time in the Monthly Review of this bank and in the Federal Reserve Bulletin.

2. *Loans and discounts.* The future of a bank's loans depends upon its ability to adapt its practices to relevant principles of credit extension. Credit requirements have not remained fixed in the midst of great changes in other fields, and traditional methods of analysis call for thorough reappraisal. Compilation and careful systematic review of a list of the wide variety of

Work Sheet 2

Analysis of Deposit Ownership

(In thousands of dollars)

Classes of Deposits	1939	Feb. 29 1944	War Peak	Post-War Estimates	
Demand deposits of individuals, partnerships and corporations					
1. Manufacturing and mining....					
2. Public utilities, transportation, and communications					
3. Retail and wholesale trade and dealers in commodities					
4. All other **nonfinancial** business, construction, and services					
5. Financial business					
6. Nonprofit associations, clubs, churches, etc.					
7. Personal (including farmers)					
a. Farmers					
b. Other personal accounts..					
8. **Total**—All demand deposits of individuals, partnerships and corporations....					
9. **Time deposits (other than bank)**					
10. **U. S. Government deposits.**					
11. **Deposits of states and local political subdivisions**					
12. **Bank deposits**					
13. **All other deposits.**.........					
14. **Grand total**—All deposits....					

types of loans that are extended is a useful technique in assuring oneself that no possibilities will be overlooked. A partial list of this type follows:

1. *Agricultural loans:* Home improvements, soil improvements, equipment purchases, farm buildings (permanent), livestock production, crop production, community and county groups, farm mortgage loans, personal.

2. *Personal and instalment loans:* Insurance loan, signature, co-maker, automobile and truck, appliances, airplane, education, insurance premium, collateral, personal mortgage.

3. *Merchant loans:*
   (a) Short term: Working capital, funds to carry increased volume of inventory, accounts receivable financing, shift in terms of selling goods.

   (b) Term and mortgage loans: Expansion into new quarters, purchase of existing building or new equipment, major alterations and improvements, purchase or opening of new outlets or branches.

4. *Industrial loans:*
   (a) Short term: Inventory, receivable, equipment, conversion, cash working capital, field warehousing, instalment.

   (b) Intermediate or term: Equipment, security refinancing, capital retirement, construction.

5. *Utility companies loans:*
   (a) Short term: Appliance sales, working capital, maintenance and improvement to be paid within one year.

   (b) Term loans: Conversion of or addition to existing facilities, replacement of old equipment, refunding other obligations into a lower rate obligation, finance purchase of other companies.

In estimating its prospective loan volume a bank may prepare separate schedules of loan prospects for each of its major types of customers such as farmers, consumers, merchants, industries, utilities, and transportation companies. Conferences with customers in which they are stimulated to prepare for the post-war period will be mutually beneficial.

3. *Government securities.* Government securities have become and almost certainly will remain not only the largest asset of banks but also the avenue through which individual banks will adjust their positions. Banks secure needed funds from the Reserve Banks via these securities and the Reserve Banks provide additional reserves to the market through them. It is primarily for these reasons that a bank may properly plan its Government securities portfolio with reference to its prospective changes in deposits and loans.

The analysis should answer a number of important questions: Are the Government securities properly distributed so that together with cash they will meet the requirements that may arise from loss of deposits or expansion of loans or both? Does the ability to secure funds depend upon maturities? sale in the market? or access to the Reserve Bank? Often forgotten but equally important to the future of the institution is an opposite question: Are the resources in excess of prospective needs to meet withdrawals and loan demands being maintained in highly liquid form at low yields? A simple schedule such as that shown in Work Sheet 3 will facilitate answering such questions.

Procedures similar to those described for the three major accounts may be followed in analyzing other accounts. The detail, of course, would vary with banks. Some may make particularly exhaustive analyses of their real estate holdings, others of their lower-grade security holdings, still others of their capital position. After these analyses have been completed, it would be possible to construct tentative preliminary balance sheets and budgets.

The net result would be that the management would know where it stood, would have an estimate—based upon systematic

Work Sheet 3

Maturity Distribution of Cash and Government Securities

	1944	Post-war
Immediate—Cash, savings bonds, and Treasury bills	$........	$........
Maturities		
Up to 1 year	....	....
1 to 5 years	....	....
5 to 10 years	....	....
Over 10 years	....	....

study of the best and most complete information available—of where it was headed, and would be able to devise a program of action to attain its goal. The fortune of each bank is determined fundamentally by the capacity of its management, which alone can devise appropriate policies and translate them into action. As the Baruch-Hancock report on war and post-war adjustment policies expresses it: "No plan can be better than its administration, and no formula or law can supplant—or supply—good judgment and ability."

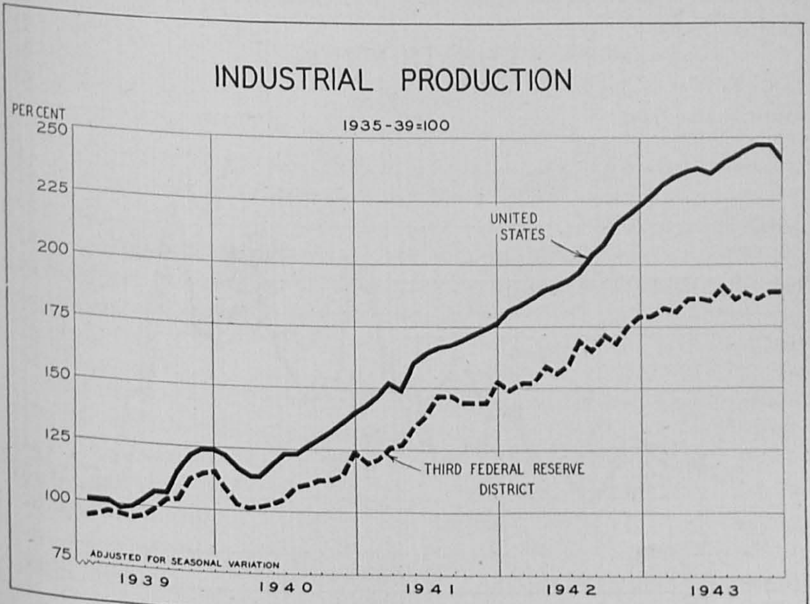
Business Conditions

Industrial output during 1943 continued to expand and now has reached a level beyond which it would be difficult to go without further expansion in capacity, materials and manpower. Since the outbreak of the war total production in this district almost doubled and the output of certain war goods has expanded as much as seven times.

Income of the population, resulting primarily from war expenditures, also has expanded to the highest peak on record and continues to increase. The supply of goods for civilian consumption at the same time was remarkably well maintained and increases in expenditures for such goods reflected principally price advance.

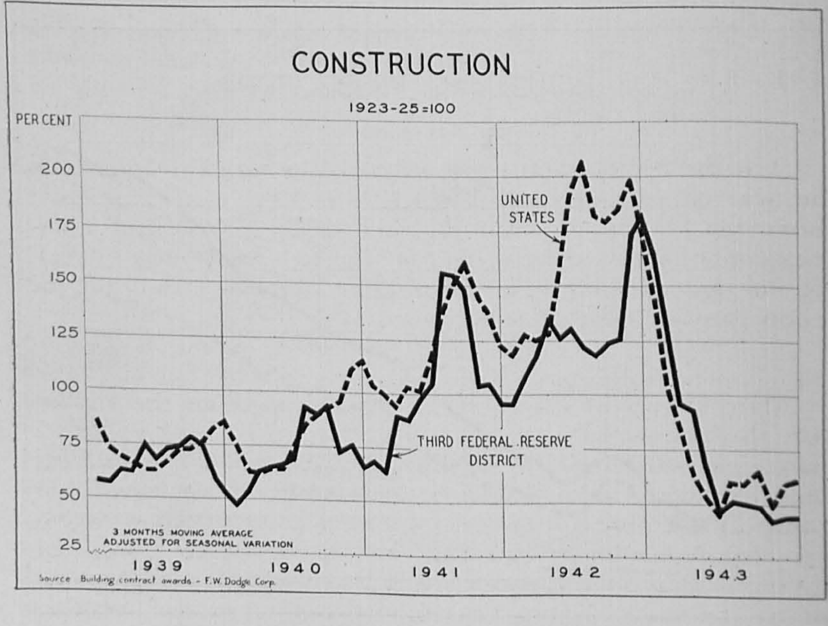
The problem of unbalance arising from the tremendous growth in spendable income and a limited stock of civilian goods has continued to be the chief element in the domestic economy by reason of its actual and potential dislocating pressure upon the price structure. Price distortions of the magnitude that occurred during the last World War have been prevented principally by greatly increased taxes, price controls and rationing, sales of Government securities, and the general public attitude toward spending and war financing. The liquidity of individuals and business has increased enormously, as evidenced by cash holdings, deposit ownerships and purchases of Government obligations. The significance of this development will become more apparent when its influence on economic conditions becomes fully felt after the war.

In its transformation from peace to total war, our economy went through three stages. The first phase, from the fall of France to Pearl Harbor, was characterized by an expansion both in production for peace and production for war.



The outbreak of war in December 1941 plunged us into the second phase of preparation—the conversion of existing plant facilities from peace to war production and an intensive building of new facilities. As demand for war materials was intensified, production of civilian goods, like radios and automobiles, was cut off completely and the facilities thus released were speedily geared into war production. Actual war caused military demands to rise far beyond our productive capacity. Tremendous additions had to be made to our facilities in such industries as shipbuilding, aircraft, metals, and chemicals. Military and naval construction constituted a large part of the huge expansion in construction activity. The construction of new facilities had been substantially completed by 1943.

The third phase of the transition was the attainment in 1943 of a smoothly running war economy. Construction fell away sharply, releasing both manpower and materials for employment



in the enlarged war plant. Industrial production continued to expand, and it is significant to note that the enormous output of war supplies was attained without serious curtailment of essential civilian needs. The well sustained output of civilian goods was an important factor counteracting the inflationary pressure of greatly expanded purchasing power. Industrial production leveled off in the latter part of 1943 indicating the approach of maximum utilization of capacity.

Business activity in the Third District closely paralleled that in the United States. The economy of this district went through the same stages—over-all expansion during the period of preparedness, construction of additional facilities during the first year of war, and the attainment of full productive capacity in 1943.

By reason of its well-established industrial facilities, diversification, and labor skills, this district has played an important role in supplying the armed forces with the necessary implements of war. Both prime contracts and innumerable subcontracts awarded in the district completely converted this area into a war economy of the first order.

The district threw the full weight of its varied resources into the war effort; industrial production in 1943 was 82 per cent above the 1939 level. From the very outset its diversified industries contributed a great variety of war materials in ever increasing volume. The response of its leading industries is shown in the accompanying table of production.

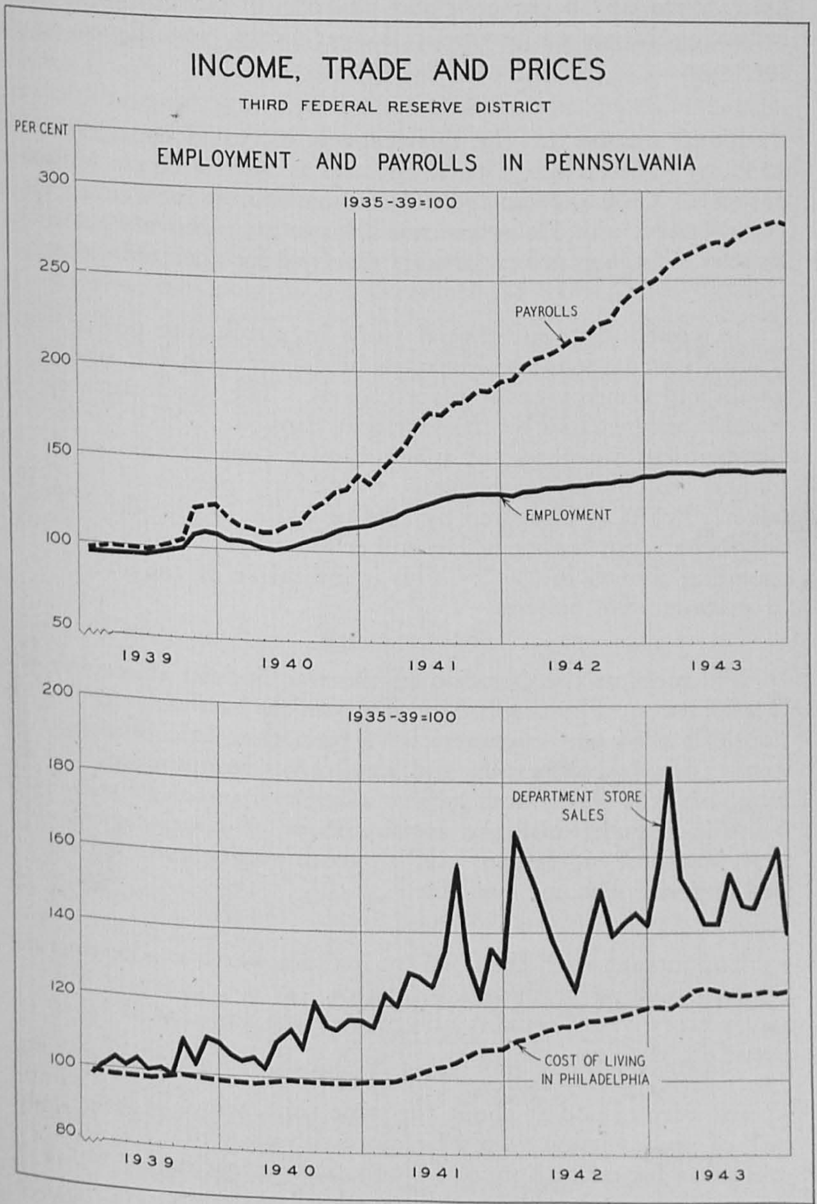
Manufacture of transportation equipment made the greatest gain throughout the war period; production in 1943 was more than eight times the pre-war level. This industry, embracing ships, aircraft, motor trucks, and a variety of specialized war transport equipment, supplied one of the country's most urgent war requirements. Shipbuilding was the largest component of this industry and the sevenfold increase in production is accounted for by the quick response and rapid expansion of the Delaware

Industrial Production Third Federal Reserve District	Average 1939	June 1940	December 1941	Average 1942	Average 1943
Total production	**100.0**	**103.6**	**149.9**	**159.8**	**181.9**
Manufacturing	**100.0**	**103.1**	**156.4**	**166.1**	**192.0**
Durable goods	100.0	121.2	229.2	279.0	345.4
Consumers' goods	100.0	92.2	113.6	101.6	103.8
Metal products	100.0	122.7	211.2	215.2	241.4
Textile products	100.0	78.5	101.8	87.6	85.7
Transportation equipment	100.0	126.5	360.9	575.2	825.9
Food products	100.0	108.9	120.0	121.9	137.8
Tobacco	100.0	97.8	152.8	121.3	108.0
Building materials	100.0	103.3	154.2	137.7	105.6
Chemicals and products	100.0	106.0	135.1	114.9	131.9
Leather and products	100.0	90.7	112.7	96.5	90.1
Paper and printing	100.0	102.5	111.4	104.6	107.3

River shipyards. Metal production also expanded very rapidly in this district owing largely to the stimulus of shipbuilding which is the largest wartime customer of the steel industry.

All of the major industries made considerable gains throughout the year and a half of preparedness, but after December 1941, the demands of total war affected various industries in different ways. Some, like textiles and leather, easily convertible to war production, attained an early peak of war expansion and have since declined. Production of processed food, much of which is destined for foreign shipment, continued to expand. Production of building materials rose rapidly in response to the huge war construction program but declined sharply in 1943 as new construction projects neared completion. Although the output of steel, ordnance, ships, aircraft, and related war materials was generally higher in 1943, there was some recession in the production of these materials toward the end of the year.

Throughout 1943, industries of this district faced a growing scarcity of labor. Production generally was not seriously hampered but labor shortages became acute in some areas, notably Allentown, Trenton, Chambersburg, and Wilmington. Factory employment in Pennsylvania was only 5 per cent higher in 1943 than the average for the twelve months preceding. Employee-


INCOME, TRADE AND PRICES
THIRD FEDERAL RESERVE DISTRICT
PER CENT
EMPLOYMENT AND PAYROLLS IN PENNSYLVANIA
1935-39=100
300
250
200
150
100
50
PAYROLLS
EMPLOYMENT
1939
1940
1941
1942
1943
200
1935-39=100
180
160
140
120
100
80
DEPARTMENT STORE SALES
COST OF LIVING IN PHILADELPHIA
1939
1940
1941
1942
1943

hours were up 10 per cent and payrolls 20 per cent—the latter reflecting larger employment, longer hours, and higher hourly earnings.

Total income of the district was increased considerably in 1943 by greater agricultural income as well as larger industrial payrolls. Cash income from farm marketings for Pennsylvania, New Jersey, and Delaware was 24 per cent above 1942 owing largely to higher prices farmers received for their products.

In contrast to substantial gains in purchasing power, retail trade showed moderate increases in dollars with the amount of goods sold continuing at record levels. The significance of this trend is accentuated by the fact that the volume does not include Government purchases of many similar consumption goods for soldiers which they, as civilians, would have purchased for themselves. Prices as measured by cost of living in Philadelphia were only 3 per cent higher in December as compared with the corresponding month in 1942. This is indicative of the effectiveness of price control policies.

Throughout the duration of the war, industrial activity will be affected most by the shifting needs on the battlefronts. Already $12 billion of war contracts have been canceled, affecting such items as explosives, tanks, and small arms ammunition. Simultaneously, the need for ships, aircraft, signal and electronic equipment increased. Military requirements, of course, must come first, but some increases of civilian goods may be expected as labor and materials become available.

Concurrent with the need for making wartime adjustments is the necessity of preparing for peace. It is frequently assumed that victory over Germany will precede the downfall of Japan and therefore that the transition from war to peace can be made in two relatively easy stages. However, if the wars in both hemispheres were to end at about the same time, which is possible, the task of reconversion would be more complicated. Furthermore, preparing for peace is more difficult than preparing for war, since the problems of marketing will be added to those of production.

Preparation for peace must be early and systematic. Government, management, and labor must cooperate in a common cause to provide work opportunities for the men and women returning from the armed forces and for those now engaged in war production.

While at war, the Government is the mainspring of our economy because it is the largest producer of war materials, the largest employer of labor, and the largest customer of private industry. Its demobilization policies are, therefore, of utmost importance. As many as 8 million men and women may be released from the armed forces. Unfinished contracts to be terminated will probably amount to $60 billion. Immense quantities of Government property will have to be removed before private plants can prepare for peacetime operations. The Government also has about $16 billion of industrial plants and huge stores of materials to be disposed of after the war. The manner in which these materials and plants are integrated into our industrial organization will have profound effects upon the future of our whole national economy.

The job of reconversion which industry faces consists of two essential parts. The first and less difficult, is the reshaping of physical facilities and the reestablishment of assembly lines for the production of civilian goods. This aspect of the job is easily mastered. The war taught American industry the art of speedy adaptation of mass production techniques to rapidly changing product specification. This art can be applied to advantage in the shift from war to peace.

The second and more difficult part of reconversion is merchandising—adapting products to the market. In time of war, merchandising takes a holiday; after the war, markets must be reestablished. This is a far more comprehensive job than mere setting up of quotas of anticipated sales. It is the production of goods and services that people will buy that makes a market. To assure a post-war market of $150 billion calls for all the imagination and ingenuity that can be mustered.

The cooperation of labor is no less essential to the effective solution of post-war problems. Labor wants full peacetime consumption, employment, and production. These goals are closely interrelated. Their attainment depends in large part upon the attitudes and policies of working men and women with respect to working hours, compensation, and output standards. A realistic and therefore constructive approach to these problems is one of the most important contributions labor can make.

The process of reconversion in the Third District may be somewhat different and, in certain respects, less difficult than in other parts of the country. Despite changes brought about by the war, the district still has a well-balanced and highly diversified economy. As compared with other areas, this district has a comparatively smaller volume of newly-built war facilities to absorb into its peacetime industrial structure. Furthermore, a substantial proportion of the new facilities built here by the Government is readily convertible to the production of civilian goods. Only 56 per cent of these new plants produce strictly combat material, in contrast to as much as 88 per cent elsewhere.

However, the war has wrought great changes in local areas within the district, and where the greatest changes have occurred, the greatest readjustments will have to be made. The war expansion of industries has caused 200,000 people to move into the highly industrialized section of the Delaware River Valley. At the same time, approximately 135,000 people have left the anthracite region and 20,000 people have moved out of the bituminous area. Though of an entirely different nature, the post-war problems are considerably magnified in local areas that have gained population, as well as in those that have lost.

Post-war planning is engaging the attention of numerous agencies, both public and private. The war has produced vast changes in the distribution of both human and material resources. Any plans now formulated should provide for the most effective utilization of these resources in years to come. The urgent task at the end of the war will be to provide productive jobs for men and women returning from the armed services and for those currently employed in war production.

Federal Reserve Bank

Adjustment of the Federal Reserve System to changing conditions is reflected in its activities in special fields of credit as well as in its strictly central banking policies.

Primarily as a result of the depression of the 1930's, some established but financially embarrassed concerns were unable to secure credit through regular channels. Section 13b was added to the Federal Reserve Act to meet "the need of many small and medium-sized commercial and industrial businesses for additional working capital, to enable them to continue or resume normal operations, and to maintain employment or provide additional employment." It authorized the Reserve Banks to make industrial loans "in exceptional circumstances when it appears to the satisfaction of a Federal Reserve Bank that an established industrial or commercial business located in its district is unable to obtain requisite financial assistance on a reasonable basis from the usual sources . . ." The purpose of Section 13b was to facilitate the rehabilitation of firms and put them in condition to obtain credit from regular sources. As was to be expected, many applications were received almost immediately, but the number declined rapidly with improvement in general business conditions.

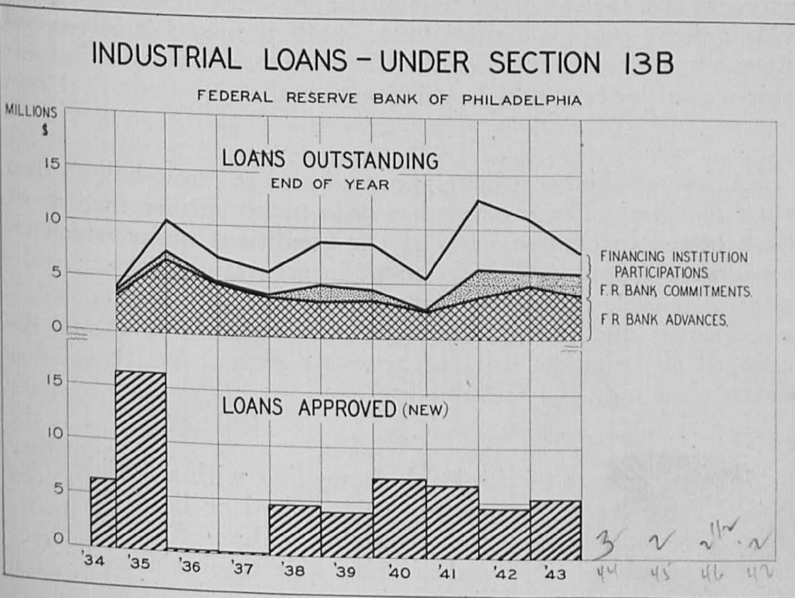
When the war broke out it became apparent that new credit methods and mechanisms had to be devised quickly. In the case of plant construction and expansion, liberalized terms of amortization for tax purposes were provided so that the cost of investment might be written off in five years. Another method was the Emergency Plant Facilities Contract which enabled a contractor to build a plant with his own funds and hold title until the Government reimbursed him in sixty monthly instalments. Contracts arising from this arrangement are guaranteed and so are eligible for collateral for term loans at banks. Finally, the Defense Plant Corporation was created to finance with Government funds the construction of facilities for lease to private operators.

The task of providing funds for working capital also required new approaches to credit to speed production of war supplies urgently needed by the armed forces. In addition to dependence of concerns upon their own resources for this type of capital and upon the banks for ordinary commercial loans, a system of so-called "advance payments" or advances on Government contract awards was instituted. In October 1940 concerns were enabled to assign funds arising from Government contracts as collateral for bank loans. Later a system of guaranteed lending—the so-called V and VT loans—was worked out and adopted. An analysis of the experience of this Bank in these developments suggests several significant conclusions.

Industrial loans—Sec. 13b

The industrial loan program started at almost the depth of the depression and was limited to loans that commercial banks were unable or unwilling to make on their own responsibility. Each application was analyzed by the Credit Department. Some could not be accepted because they were ineligible under the restrictions of the law. Other reasons for rejections included unsatisfactory financial conditions, unsatisfactory earnings records, insufficient collateral, and unsatisfactory management or prospects. Although more loans have been rejected than have been approved, the dollar amount of rejections is considerably less than the amount granted. Substantial loans to larger concerns accounted for the major part of the funds extended, but most loans were made for small amounts and to small establishments.

Applications for industrial loans Federal Reserve Bank of Philadelphia	1943	June 30, 1934-December 31, 1943
Number		
Approved	24	347
Rejected	1	457
Withdrawn	2	68
Total number	27	872
Amount		
Approved	$5,339,198	$56,456,426
Rejected	30,000	17,126,350
Withdrawn	535,000	3,991,700
Total amount	$5,904,198	$77,574,476



Section 13b enabled commercial banks to secure the assistance of the Federal Reserve Banks in the extension of working capital loans to businesses that were unable to meet the requirements of banks to extend credit entirely at their own risk. As illustrated in the accompanying chart, participation by commercial banks in total loans and commitments outstanding rose to more than 50 per cent in 1940. In no case has a financing institution requested this Bank to take over the loan on the basis of its commitment. Since that time other lending methods, primarily regular bank loans and guaranteed loans under Regulation V, have been used to finance the expanded activity resulting from the war.

Since 1934 total earnings of this Bank on industrial loans have amounted to $1,838 thousand, of which $547 thousand has been paid to the United States Treasury, $530 thousand has been transferred to surplus, and the remaining $760 thousand has been used to cover expenses, losses, and reserves. Losses charged off have been only $67,618, or considerably less than 4 per cent of total earnings and about 0.1 per cent of the amount extended. To provide against possible future losses, $115 thousand is in reserves. Even were losses to absorb all of these reserves—which is improbable—total losses would be relatively small.

A few of the loans have appeared on the "trouble list" from time to time. The number has been much smaller than might have been expected in view of the conditions under which the loans were granted. Improvement in general conditions enabled some to remove themselves from the "trouble list" even before the war began; and the general expansion resulting from the war reduced the number still further. At present less than half a dozen remain on the "trouble list".

The experience of this Bank shows that with a flexible credit policy these loans, presumably substandard or borderline, have proved reasonably safe and profitable. Most of the borrowers have been rehabilitated and are now able to obtain credit from their regular sources. This experience suggests that if banks make adequate provision for subsequent losses, they can take risks, especially when the need is greatest and the outlook darkest. The time for caution and a restrictive policy is a period of boom.

These loans represent only one type of credit. The volume of loans outstanding under Section 13b has been small in comparison with the total loans of member banks in this district—less than 1 per cent at the end of 1943. Policies similar to those followed in the industrial loans program might be applied to other types and new types of loans in the post-war period with profitable returns to commercial banks.

Regulation V Guaranteed loans were authorized in March 1942 to remedy inadequacies in earlier devices and to enable commercial banks to make greater use of their facilities in financing the war effort. The Federal Reserve Banks were authorized to act as agents of the War Department, Navy Department, and Maritime Commission in guaranteeing loans to concerns engaged in war production and requiring credit beyond normal credit lines. The initial purpose was served through so-called Regulation V loans. In anticipation of the need to free funds at cancelation and to facilitate speedy reconversion, the "VT" or guaranteed contract termination loan was devised in 1943. The proposed "T" loan is solely to free, at termination, working capital of contractors who have not borrowed under Regulation V. The basic

Selected Borrowers under Regulation V (Thousands $)	12 Firms Assets Under $500,000		29 Firms Assets $500,000-$5,000,000		16 Firms Assets Over $5,000,000	
	1943	Change from 1941	1943	Change from 1941	1943	Change from 1941
Assets						
Cash	$ 281	+ $205	$ 4,441	+ $ 3,133	$ 66,333	+ $ 34,126
Receivables	582	+ 269	14,181	+ 7,608	93,365	+ 37,471
Inventory	549	+ 174	14,397	+ 3,706	138,224	+ 53,482
Gov't securities	3	+ 3	2,759	+ 2,599	55,589	+ 55,589
Other	1	— 1	310	+ 40	515	+ 508
Current assets	**$1,416**	**+ $650**	**$36,088**	**+$17,086**	**$354,026**	**+$181,176**
Fixed assets (gross)	840	+ 86	16,200	+ 3,116	144,809	+ 31,298
Post-war refund	5	+ 5	618	+ 618	9,612	+ 9,612
Other	186	+ 17	3,081	+ 608	14,453	+ 641
Total assets	**$2,447**	**+ $758**	**$55,987**	**+$21,428**	**$522,900**	**+$222,727**
Liabilities						
Accounts & notes payable	$ 283	— $162	$ 4,916	+ $ 1,331	$ 46,257	+ $ 11,265
Bank loans	328	+ 318	10.451	+ 7,577	68,512	+ 53,890
Accruals	198	+ 151	9,937	+ 6,557	115,523	+ 82,805
Other	29	— 28	800	— 61	21,830	— 3,648
Current liabilities	**$ 838**	**+ $279**	**$26,104**	**+$15,404**	**$252,122**	**+$144,312**
Funded debt	107	— 58	993	— 588	6,003	— 9,033
Reserves	361	+ 108	9,261	+ 2,998	82,026	+ 37,287
Other	67	— 10	425	+ 248	17,733	+ 16,854
Capital accounts	1,074	+ 439	19,204	+ 3,366	165,016	+ 33,307
Total liabilities	**$2,447**	**+ $758**	**$55,987**	**+$21,428**	**$522,900**	**+$222,727**
Net working capital	$ 578	+ $371	$9,984	+ $ 1,682	$101,904	+ $ 36,864
Percentage improvement in net working capital since 1941		+179%		+ 20%		+ 57%

purpose of the guarantee procedure is to aid concerns whose credit standing does not enable them to secure adequate regular bank loans large enough to finance their greatly expanded volume of production for war purposes. Its success is shown in the fact that by the end of 1943 the Reserve Banks had authorized 5,347 loans for a total of \$6,563 million, of which \$1,914 million was outstanding. Concerns of all sizes have been assisted. In this district most of the borrowers have total assets of less than \$500,000 and borrowed less than \$100,000. On the other hand, some of the loans exceed \$5 million. Two or more banks have participated in extending some of these loans.

Changes in the financial position of selected borrowers under Regulation V are shown in the accompanying composite balance sheets of firms for which comparable data are available. The rapid growth in assets—an increase of about two-thirds in two years—largely because of war conditions, explains why they were unable to secure sufficient credit through regular channels without guarantees. Most of the growth has been in current assets, and although current liabilities also have increased, net working capital has increased considerably—57% for the largest firms in the table, and 179% for the smallest. Ability to meet liabilities as they fall due will require conversion of inventories and receivables into cash. These assets in turn are interwoven with war contracts and depend on how expeditiously settlements are made.

Federal Reserve credit

System policy of maintaining stable financial conditions resulted in an expansion in the total assets of the Bank from \$1.7 billion to \$2.1 billion in the year 1943.

The chief item in this expansion was holdings of U. S. Government securities, which remain overwhelmingly the most important component of Federal Reserve Bank credit. These holdings almost doubled in 1943, increasing from \$440 million to \$862 million; at the end of the year they accounted for 42 per cent of the Bank's assets in contrast to 25 per cent in 1942 and 12 per cent in 1941. Participations in Government securities purchased by the Federal Open Market Committee were generally below their 1942 year-end level for the first ten months of 1943; but

Statement of Condition

Federal Reserve Bank of Philadelphia (000's omitted in dollar figures)	December 31 1941	1942	1943
RESOURCES			
Gold certificates on hand and due from U. S. Treasury	$1,224,286	$1,147,114	$1,029,794
Redemption fund—Federal Reserve notes	892	5,666	24,120
Other cash	19,344	21,190	24,499
Total reserves	$1,244,522	$1,173,970	$1,078,413
Total bills discounted	674	2,380	700
Industrial advances	3,468	4,710	4,046
United States Government securities	177,982	440,168	861,738
Total bills and securities	$ 182,124	$ 447,258	$ 866,484
Due from foreign banks	5	5	13
Federal Reserve notes of other F. R. banks	2,700	2,541	4,620
Uncollected items	84,370	114,047	117,062
Bank premises	4,866	4,755	3,600
All other resources	4,061	6,925	4,815
Total resources	$1,522,648	$1,749,501	$2,075,007
LIABILITIES			
Federal Reserve notes in circulation	$ 575,036	$ 848,682	$1,149,726
Deposits:			
Member bank reserve account	661,703	651,566	645,809
United States Treasurer—general account	73,577	52,643	31,375
Foreign	74,057	67,100	120,273
Other deposits	12,392	4,672	5,351
Total deposits	$ 821,729	$ 775,981	$ 802,808
Deferred availability items	90,557	89,503	84,031
Other liabilities	839	524	875
Total liabilities	$1,488,161	$1,714,691	$2,037,441
CAPITAL ACCOUNTS			
Capital paid in	$ 11,923	$ 11,747	$ 11,686
Surplus—Section 7	15,171	15,670	17,859
Surplus—Section 13b	4,393	4,393	4,421
Other capital accounts	3,000	3,000	3,600
Total liabilities and capital accounts	$1,522,648	$1,749,501	$2,075,007
Ratio of total reserves to deposit and Federal Reserve note liabilities combined	89.1%	72.3%	55.2%
Commitments to make industrial advances	$2,617	$1,346	$1,930

they increased rapidly over November and December when the System helped banks adjust their reserve positions to heavy withdrawals from war loan accounts, tax payments and seasonal demands for currency. Holdings of Treasury bills under repurchase option expanded from a low of $2 million to $281 million shortly before Christmas, when they constituted almost one-third of total Government securities held. A total of 128 member banks used this privilege in 1943 to meet temporary reserve requirements. In contrast, only 50 members borrowed during the year; total discounts varied between $75,000 and $12 million.

Federal Reserve notes

Almost the entire increase in liabilities corresponding to the expansion in assets took place in outstanding Federal Reserve notes. This amount grew continually over the year, crossing the billion mark in July. The increase of $301 million, while larger in dollars, represents a slower rate of increase compared with the two preceding years—an increase of 35 per cent in contrast to 48 per cent in 1942 and 40 per cent in 1941.

Earnings and expenses

Doubling of the holdings of Government securities is largely responsible for the increase of 28 per cent in total earnings of this Bank from $4.2 million to $5.3 million. The difference in the rates of increase was a result of shifts from longer-term and higher-yielding bonds and notes to certificates and to bills held largely under repurchase option. Government security holdings supplied 96 per cent of total earnings.

Net expenses increased at a much slower rate and as a result current earnings were up 81 per cent from $1.2 million to $2.2 million. Profits on sales of Government securities, reflecting the policy of the System in maintaining stability in the money market, added substantially to net earnings. Net earnings of $3.6 million available for distribution were higher than in any other year since 1921, with the exception of 1929. Of these earnings, $701,000 was paid in dividends and $2.8 million was transferred to surplus under Section 7. In addition, $84,000 was paid to the Treasury, and $28,000 was transferred to surplus under Section 13b.

Profit and loss account Federal Reserve Bank of Philadelphia (000's omitted)	1941	1942	1943
Earnings from:			
United States Government securities	$3,179	$3,947	$5,122
Other sources	165	227	217
Total earnings	$3,344	$4,174	$5,339
Expenses:			
Operating expenses*	$2,283	$2,455	$2,498
Cost of Federal Reserve currency	184	334	409
Assessment for expenses of Board of Governors	179	167	229
Total net expenses	$2,646	$2,956	$3,136
Current net earnings	$ 698	$1,218	$2,203
Additions to current net earnings:			
Profits on sales of U. S. Government securities	$ 110	$ 277	$2,928
Transfers of reserves in excess of requirements	2	150	100
Other additions	14	8	13
	$ 127	$ 435	$3,041
Deductions from current net earnings	3	414	1,642**
Net additions to current net earnings	$ 124	$ 21	$1,399
Net earnings available for distribution	$ 822	$1,239	$3,602
Distribution of net earnings:			
Paid to Treasury of United States, Sec. 13b	$ 81	$ 32	$ 84
Dividends paid to member banks	713	708	701
Transferred to surplus (Sec. 13b)	0	0	28
Transferred to surplus (Sec. 7)	27	499	2,789

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

**Principally charge-off on bank premises and payments to Retirement System.

Volume of work

As a result of the war, the volume of service functions which the Bank performs has expanded tremendously. The increase in some of these operations is summarized in the following table.

Volume of operations Federal Reserve Bank of Philadelphia	1941	1942	1943
Pieces or transactions handled (000's omitted)			
Discounts and advances	1	1	1
Currency counted	185,500	195,492	200,093
Coins counted	365,350	419,613	433,502
Ordinary checks	109,124	109,701	110,713
Checks handled in packages by automobile run service	18,567	17,801	17,608
U. S. Government checks (including Treasury card checks first handled in 1943)	5,439	10,236	23,389
Work relief checks	2,797	1,250	0
Ration checks	....	....	4,993
Collection items:			
Coupons of U. S. Government and agencies	1,077	1,129	1,214
All other (notes, drafts, and coupons)	318	271	212
Transfers of funds	55	59	61
Issues, redemptions, and exchanges by Fiscal Agency Department:			
U. S. Government direct obligations*	881	7,654	19,717
All other	13	32	4
Dollar amounts (000,000's omitted)			
Discounts and advances	$ 15	$ 29	$ 327
Currency counted	799	932	1,015
Coins counted	32	37	40
Ordinary checks	33,882	38,748	43,593
U. S. Government checks (including Treasury card checks first handled in 1943)	1,446	3,520	6,723
Work relief checks	91	52	0
Collection items:			78
Coupons of U. S. Government and agencies	47	57	224
All other (notes, drafts, and coupons)	232	202	7,158
Transfers of funds	4,366	5,470	
Issues, redemptions, and exchanges by Fiscal Agency Department:			
U. S. Government direct obligations*	1,023	3,751	8,014
All other	100	108	17
Securities held in custody for member banks at end of year	$753 mil.	$1,192 mil.	$1,651 mil.
Savings bonds in safekeeping at end of year (number of pieces)	19,000	59,000	133,000

* Includes savings bonds sold through other issuing agents.

The departments most directly affected by the war have been Currency, Transit, and Fiscal Agency. As the demands for currency continued to rise, almost 5 million more pieces of currency and 14 million more coins were counted by the Currency Department this year than last. Increased Treasury payments required the Transit Department to handle 13 million more Government checks, more than twice the number in 1942. Increases in other payments were reflected in the greater volume of ordinary checks passing through this department.

The work of the Fiscal Agency Department increased greatly over the year, necessitating a net addition of 108 employees to this department. Over 19 million direct U. S. Government obligations were issued, redeemed, or exchanged as compared with 7 million in 1942.

Membership Member banks comprise about three-fourths in number and hold similar proportions of deposits and assets of all banks in the Third Federal Reserve District. If mutual

Banks in Third Fed. Res. District December 31, 1943 (Partly derived) (Millions $)	Total	Member banks	Mutual savings banks	Other non-members
Assets				
Loans and discounts	1,121	852	87	181
U. S. Govt. obligations	3,626	2,764	369	493
Other securities	809	427	270	112
Cash assets	1,377	1,167	33	177
Fixed assets	176	106	23	47
Other assets	35	24	4	7
Total	7,144	5,340	786	1,017
Liabilities and Capital Accounts				
Deposits:				
Individuals, partnerships, and corporations—				
Demand	3,148	2,709	—	439
Time	2,052	1,047	723	282
U. S. Government	545	484	—	60
Bank	374	367	—	7
Other	316	223	—	93
Total deposits	6,435	4,830	723	881
Other liabilities	26	19	1	6
Capital accounts	682	491	61	130
Total	7,144	5,340	786	1,017
Number of banks	889	646	10	233

savings banks are excluded, the member bank proportions of major balance sheet items exceed four-fifths. Several banks were admitted to membership during 1943, but the number of members was reduced somewhat—from 652 to 646—principally by absorptions. War conditions were reflected in continued rapid growth in the assets of both member and nonmember banks, approximating 15 per cent in the year; investments in Governments were sharply increased, and concurrent gains were shown in deposits, mostly in the balances of individuals and business concerns. Summary figures showing the principal assets and liabilities of member and other banking institutions in this District are given in the preceding table.

Directors and officers

There were two changes in the Board of Directors of the Bank. James T. Buckley, Chairman of the Executive Committee of the Philco Corporation, Philadelphia, was elected by the banks in Group 1 as a Class B director for a term of three years, to succeed C. Frederick C. Stout, whose term expired on December 31, 1943. Mr. Stout had been a director for sixteen years. C. Canby Balderston, Dean of the Wharton School of Finance and Commerce of the University of Pennsylvania, was appointed a Class C director on April 9, 1943, to fill the vacancy created by the resignation of Winfield W. Riefler in the fall of 1942.

Thomas B. McCabe was redesignated Chairman of the Board and Federal Reserve Agent for the current year, and Warren F. Whittier was reappointed a Class C director for the three-year term beginning January 1, 1944, and redesignated Deputy Chairman for the year 1944.

At the regular election in the fall of 1943, John B. Henning was reelected a Class A director by member banks in Group 3.

By appointment of the Board of Directors, William Fulton Kurtz, President of the Pennsylvania Company for Insurances on Lives and Granting Annuities, continued as the member of the Federal Advisory Council from the Third Federal Reserve District.

The only change in the official staff was the appointment of Robert N. Hilkert, Personnel Director, as Assistant Vice-President as of October 1, 1943.

Directors
as of January 1, 1944

	Group	Term Expires December 31
Class A:		
Howard A. Loeb. Chairman, Tradesmens National Bank and Trust Company, Philadelphia, Pennsylvania.	1	1944
George W. Reily. President, Harrisburg National Bank, Harrisburg, Pennsylvania.	2	1945
John B. Henning. President, Wyoming National Bank, Tunkhannock, Pennsylvania.	3	1946
Class B:		
James T. Buckley. Chairman, Executive Committee, Philco Corporation, Philadelphia, Pennsylvania.	1	1946
Harry L. Cannon. President, H. P. Cannon & Son, Inc., Bridgeville, Delaware.	2	1944
Ward D. Kerlin. Secretary and Treasurer, Camden Forge Company, Camden, New Jersey.	3	1945
Class C:		
Thomas B. McCabe, Chairman and Federal Reserve Agent. President, Scott Paper Company, Chester, Pennsylvania.		1945
Warren F. Whittier, Deputy Chairman. Lonicera Farms, Douglassville, Pennsylvania.		1946
C. Canby Balderston. Dean, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia, Pennsylvania.		1944

Officers
as of January 1, 1944

ALFRED H. WILLIAMS, *President*

FRANK J. DRINNEN,
First Vice President

C. A. McILHENNY,
Vice President and Cashier

W. J. DAVIS,
Vice President

ERNEST C. HILL,
Vice President

C. A. SIENKIEWICZ,
Vice President

WILLIAM G. McCREEDY,
Assistant Vice President and Secretary

L. E. DONALDSON,
Assistant Vice President

PHILIP F. COLEMAN,
Assistant Vice President

ROBERT N. HILKERT,
Assistant Vice President

JAMES M. TOY,
Assistant Cashier

PHILIP M. POORMAN,
General Auditor