

VICTORY AND BEGINNINGS
OF PEACE

Thirty-first Annual Report
of the
FEDERAL RESERVE BANK
OF PHILADELPHIA



1945

Third Federal Reserve District

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FEDERAL RESERVE BANK
OF PHILADELPHIA

March 15, 1946.

*To the Member Banks in the
Third Federal Reserve District:*

Military victory during 1945 permitted American businessmen and bankers to take stock of the effects of war and to give undivided attention to plans for peacetime operations. In this Thirty-first Annual Report of the Federal Reserve Bank of Philadelphia, war developments have been reviewed with special attention to their peacetime implications, particularly in the light of inflationary developments.

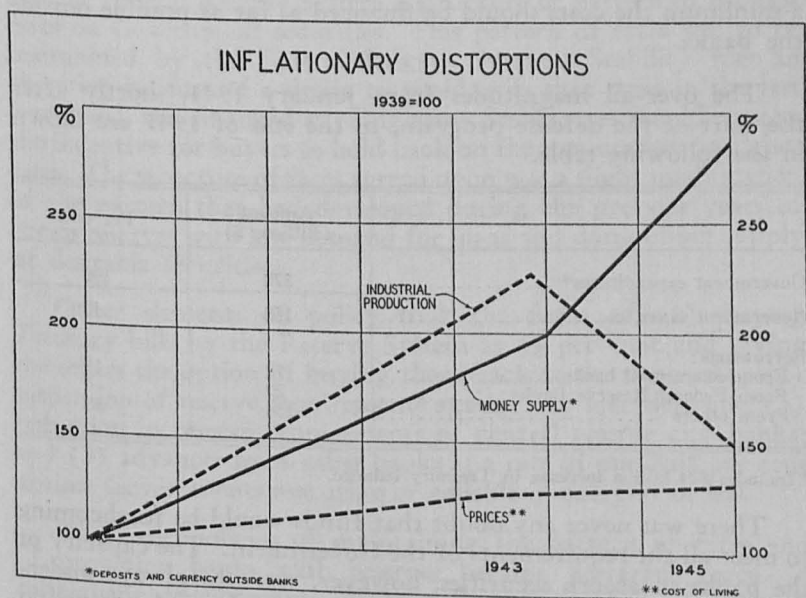
ALFRED H. WILLIAMS

President.

VICTORY AND BEGINNINGS OF PEACE

Every major war disrupts lives and leaves a heritage of maladjustment. The second World War left in its wake conflicting forces of unparalleled magnitude. One of the most important conflicts may be visualized as one between goods and services on the one hand and the supply of money on the other. Output has receded far below its peak while the supply of money is still increasing. The result is strong upward pressure on prices.

Our present problems originated largely during the war, when the most insistent need was production. Initially it was necessary to construct vast new facilities: war plants, houses for war workers, cantonments, and so on. As a result, construction skyrocketed to a peak in July 1942 almost three times as high as the level in 1939. After the major part of the expansion program



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was completed, the volume of construction declined rapidly to below the pre-war level.

Enlarged facilities together with increased employment and lengthening of work hours made possible a rapid and sustained rise in industrial output until October 1943 when production was two and one-quarter times as great as before the war. Output was maintained at slightly below this peak until the defeat of Germany in May 1945. From May until October it declined precipitately by more than one-fourth. Recovery immediately thereafter was followed by temporary recession early in 1946 as a result of wide-spread labor-management disputes.

In considering the monetary aspects of these developments it is helpful to recall that in the fiscal year 1945 nearly half of all expenditures were being made by the Federal Government. By way of contrast the maximum proportion reached in the First World War was only one-fourth. It was clear from the outset that the costs of the war—whatever their size—would have to be met. It was equally clear that if distortions were to be held to a minimum the costs should be financed as far as possible outside the banks.

The over-all magnitudes from January 1941, shortly after the start of the defense program, to the end of 1945 are shown in the following table.

	Amount (Billions \$)	Per cent
Government expenditures*	378	100
Government taxes, etc.....	150	40
Borrowings:		
From commercial banks	72	19
From Federal Reserve Banks	22	6
From others	134	35

* Includes \$24 billion increase in Treasury balance.

There was never any doubt that funds would be forthcoming to meet all the requirements of the Government. The capacity of the banks to absorb securities, however, was not always understood. At first many were prone to assume that a bank would

lose reserves when it bought securities. Such drain would occur, of course, if a single bank in a banking system increased its purchases unduly relative to its position in the system. It was forgotten, however, that reserves lost by one bank are usually gained by other banks. When most banks are expanding, the tendency to lose reserves as a result of security purchases is offset by the tendency to gain reserves from purchases by other banks.

The banking system as a whole needs reserves not to buy Government securities but to meet the requirements against the enlarged deposits with which payment for the securities is made, and to meet withdrawals of currency and exports of gold. To encourage banks that hesitated to purchase Government securities because of fear of loss of reserves, the Federal Reserve System announced that it had adequate powers and was prepared to use them "to assure that an ample supply of funds is available at all times for financing the war effort."

The next step, which was taken within a few months after Pearl Harbor, was to establish by agreement between the Treasury and the Federal Reserve System a structure or pattern of interest rates on Government securities. This pattern of rates was to be maintained by the Federal Reserve System. Stability was an objective because of a desire to avoid evils that arose in the last war which was financed at rising rates. Stable rates would remove the incentive for buyers to hold back on the expectation of higher rates. The structure of rates agreed upon was a slight modification of the pattern that had developed during the pre-war years of excess reserves with low demand for loans and diminishing supply of desirable securities.

Other elements of policy took the form of (1) buying Treasury bills by the Reserve System at $\frac{3}{8}$ per cent and giving the sellers the option of buying them back at the same rate; (2) suspension of reserve requirements against war loan deposits; (3) reduction in reserve requirements of central reserve city banks; and (4) advances to member banks at a rate of one-half per cent against Governments maturing or callable in one year or less.

The basic policies of maintaining the pattern of rates and of providing banks with reserves became powerful forces in subsequent developments. With a floor under bond prices and

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assurance of reserves there was, after an initial period of hesitancy, an accelerating movement toward the long end of the pattern. There was no incentive to postpone purchases in anticipation of higher yields, but there was a powerful incentive to invest in the higher-yielding, longer-term issues. The established pattern assured not only the higher coupon rate but also capital appreciation with the passage of time.

Initiative passed from the System to the banks and the market, and the lure of higher yields and sure profits proved irresistible. The technique of raising funds by means of drives added to the policing difficulties of the Federal Reserve System because local committees were zealous to reach high totals, and the quality of the results tended to be measured locally and nationally by the amount sold and not by the source of the funds.

In a desire to secure the higher yields on long-term issues, banks sold their short-term issues. This shift would not have added to inflationary pressures if nonbank investors had bought the short-term issues that banks were selling. Other investors, however, did not buy these issues because they also preferred the greater yields on longer issues. As a result, shorter issues came increasingly to the Federal Reserve Banks, which stood ready to acquire them at the established rates. Each such acquisition increased reserve funds with which the banks could expand their deposits. The movement into longer issues started in the area of the "bank eligibles" but finally moved to the "restricted" area as banks purchased eligibles from non-bank investors, who then competed for restricted issues. The result has been a persistent rise in bank credit and declines in medium and long-term interest rates.

One consequence of the war has been the generation of all the forces that characterize an inflationary boom. First of all we have an inadequate supply of goods. The needs and wants of the American people, long unsatisfied, are enormous. Linen closets are empty, household furnishings are threadbare, appliances and motor cars need repair or replacement, railroad equipment is run-down, housing is distressingly inadequate, and retailers' shelves have bare spots.

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Against these physical deficiencies we have an excess of spending power, accumulated during forty-four months of war and currently received as income. Personal holdings of liquid assets—cash, deposits, and Government securities—have reached \$145 billion or over three times their 1939 level and those of business have reached \$80 billion or four times pre-war. In addition there is a large potential foreign demand that will compete with domestic demand for some time to come.

The end of the war brought another element into the picture: namely, removal of certain controls and pressure to remove others. A comprehensive program of direct controls over production, distribution, wages, and prices was introduced shortly after we entered the war. The program was much more effective than the limited controls adopted in the First World War in preventing the greatly enlarged supply of money from forcing prices upward. Since the end of the war, however, practically all rationing has been discontinued and wage and price controls are less stringent. For lack of goods and because of a growing concern as to the future value of money, expenditures are being made for real estate, securities, and commodities. Evidences of strong and mounting inflationary pressures are becoming increasingly apparent.

The banking system plays a key role in mitigating or aggravating inflationary developments. Expansion in earning assets, whether in loans or securities, involves expansion of bank credit. In addition to aggravating inflationary pressures, such expansion could have other serious repercussions at the present time. The supply of high-grade, longer-term securities is shrinking. As a consequence, there is fierce bidding for such securities as remain available and yields are falling. The decline in yields tempts investors of all types, including banks, to extend their activities to lower quality securities.

The perplexing problem is how to limit the expansion of credit and yet maintain orderly conditions in the money market. If the supply of money is not restricted, inflationary forces will be aggravated. On the other hand, if credit expansion is to be restricted, the handling of the public debt would be made more difficult for the Treasury.

Physical Magnitudes

Victory was the outstanding achievement of 1945. While dramatically climaxed with a \$2 billion atomic bomb, most of the tortuous road from Pearl Harbor to Potsdam had to be fought with pre-atomic weapons forged at enormous cost in human effort and dollars.

Unity of purpose stimulated heroic deeds in the battle lines and miraculous achievements on production lines. Output of goods and services for use at home and abroad more than doubled. Gross national product climbed from \$88 billion in 1939 to almost \$200 billion in 1944; during 1945 it was maintained in about the same volume and the outlook is for continuance at a high level. Part of the increase, of course, was a result of higher prices.

After Pearl Harbor, the country's leading manufacturing plants were converted into arsenals and within a short time the country was turning out the greatest avalanche of war materials ever produced. To manufacture such a flood of materials additional facilities had to be built and all available labor power had to be utilized. Approximately \$25 billion of new plant and equipment were installed, which increased productive capacity by a very substantial amount. Employment, exclusive of agriculture, was stepped up from 30 million in 1939 to 40 million in early 1943. Hours of work were lengthened and processes were simplified and streamlined to secure maximum efficiency.

This record output of war materials, never before surpassed or equalled, was all the more remarkable because it was accomplished with a minimum of internal dislocations. Civilian consumers, though somewhat inconvenienced, were adequately supplied with most of the necessities of life. Prices were kept well under control. Despite a huge increase in spending power, civilians were able to buy necessary goods and services at prices only moderately above peacetime levels.

*Third
District
in 1945*

The outbreak of war in Europe and the beginning of national defense efforts quickened industrial production in this district. When the United States was drawn into the war the Government placed large contracts in

this area because it had ready facilities for immediate production of ships, steel, machinery, electrical equipment, textiles, food, clothing, leather, petroleum products, and many other materials urgently needed by the armed forces. By the middle of 1943 industrial output of the district was almost double the pre-war volume. Heavy industries produced less railway and industrial equipment because they had to turn out artillery, tanks, and ordnance. Light industries had to abandon household appliances and textile fabrics to make radar, small arms, parachutes, and cloth for uniforms.

Durable goods for the most part went to war and their output attained fabulous proportions. Steel output doubled; electrical equipment trebled; production at locomotive and car shops was multiplied more than four times; ships—twelve times; and aircraft—over twenty times. These magnitudes reflect the acute need for transportation in global warfare.

Production of consumer goods rose 10 to 15 per cent in the early stage of national defense activity, but after our entry into the war output of civilian products had to be and was held in check. Although production of war materials was given priority, output of most essential civilian goods and services was maintained throughout the war at levels equal to and in some instances higher than peacetime standards of consumption.

The war of course had diverse effects upon consumer goods industries. Some rose with the high tides of war, others enjoyed a brief stimulus and subsequently receded, and still others became war casualties. Canning and baking prospered throughout the war; their products were in great demand not only by the armed forces but also by civilians who had more money to spend and fewer opportunities to buy durable goods. Textiles, long prominent in this area, had an early wartime expansion that was not sustained after the large initial military requirements for fabrics had been met. Production declined, not because civilian demand was lacking but because textile mills encountered serious labor shortages. Carpets and rugs and hosiery are examples of war casualties, primarily victims of raw material shortages.

The war restored to anthracite some of its lost markets when the acute shortage of fuel oil forced conversion to coal-burning

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units. Notwithstanding a reduction in employment, larger output was obtained by working longer hours and by means of greater mechanization. Anthracite production rose from 52 million tons in 1939 to 64 million tons in 1944. Production declined in 1945 to 55 million tons as a result of a strike and continued shortages of labor.

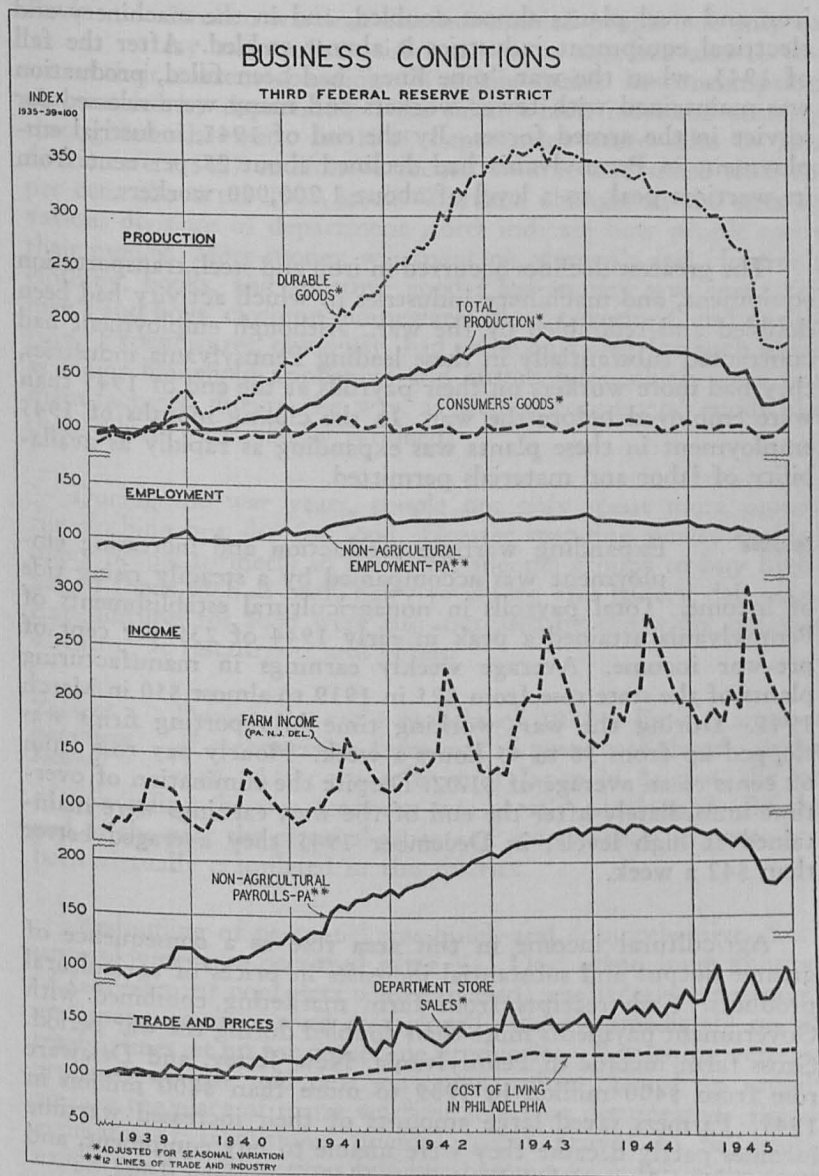
The war stimulated even greater expansion of bituminous coal to meet the heavy railroad and industrial requirements. Production of bituminous coal in Pennsylvania rose from 93 million tons in 1939 to almost 150 million tons in 1944. With the cessation of hostilities, industrial fuel requirements decreased so that bituminous output declined about 10 per cent in 1945.

Expenditures for construction in this district rose from \$200 million in 1939 to more than \$400 million in 1942—that was the period when additional facilities were being built in our industrial centers and additional housing was required to accommodate large numbers of workers who moved into these areas. Upon the completion of the building program, construction declined sharply to about \$100 million in 1944. Private construction was prohibited, which permitted the transfer of both materials and labor to essential war industries.

In 1945 over \$200 million of contracts were awarded in the district. Most of these contracts were for commercial construction. The housing shortage has been acute but revival of residential construction has been delayed by lack of materials.

To meet the almost unlimited demand for products of all kinds required substantial increases in employment. Before the war, Pennsylvania employed almost one million workers in its widely diversified industries. At the peak of the war effort, manufacturing employment in the state was in excess of 1½ million workers, which represented a gain of 65 per cent over pre-war levels. Sustained increases occurred in every major industry except leather and textiles. The greatest gains occurred in the shipyards, aircraft factories, and other plants turning out transportation equipment.

Employment in the transportation equipment industries, as a whole, rose to eight times the pre-war level. Employment in



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iron and steel plants almost doubled, and in the machinery and electrical equipment industries it almost trebled. After the fall of 1943, when the war "pipe lines" had been filled, production was maintained with fewer workers and many were released for service in the armed forces. By the end of 1945, industrial employment in Pennsylvania had declined about 25 per cent from its wartime peak to a level of about 1,200,000 workers.

The greatest declines occurred in iron and steel, transportation equipment, and machinery industries in which activity had been doubled and redoubled by the war. Although employment had contracted substantially in these leading Pennsylvania industries, they had more workers on their payrolls at the end of 1945 than were employed before the war. In the closing months of 1945 employment in these plants was expanding as rapidly as availability of labor and materials permitted.

Income Expanding wartime production and increasing employment was accompanied by a steadily rising tide of income. Total payrolls in nonagricultural establishments of Pennsylvania attained a peak in early 1944 of 235 per cent of pre-war income. Average weekly earnings in manufacturing plants of the state rose from \$25 in 1939 to almost \$50 in March 1945. During the war, working time in reporting firms was stepped up from 36 to 45 hours a week. Hourly pay rose from 69 cents to an average of \$1.07. Despite the elimination of overtime immediately after the end of the war, earnings were maintained at high levels; in December 1945 they averaged better than \$42 a week.

Agricultural income in this area rose as a consequence of greater output and substantial increases in prices of agricultural products. Cash receipts from farm marketing combined with Government payments more than doubled during the war period. Gross farm income in Pennsylvania, New Jersey, and Delaware rose from \$400 million in 1939 to more than \$800 million in 1945. Farmers saved large amounts of their increased wartime incomes partly because they were unable to buy equipment, and they made substantial reductions in their mortgage debts.

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Trade Swollen wartime incomes enabled people not only to lay aside substantial sums as savings but also to increase their current spending. Wartime trends in consumption are revealed by department store sales, which increased steadily throughout the war. In 1945 department store sales in this district were \$427 million—a record volume and more than 75 per cent above the 1939 level. Wartime changes in the sales in various divisions of department stores indicate how people spent their money. More money was spent on women's and children's clothing, books, and sporting goods; less money was spent for men's and boys' clothing, housewares, floor coverings, and furniture. Expenditures, obviously, had to be curtailed for such items as major household appliances and automobiles which were not manufactured during the war, as well as consumers' goods like shoes which were strictly rationed.

During the war years, people not only spent more money for clothing but also for food. Greater spending power enabled many people formerly in the lower income groups to buy high-priced foods such as beef, dairy products, and bakery delicacies. Expenditures for food were also increased by the wider practice of eating at restaurants and hotels.

Toward peacetime business During the early months of 1945 a limited amount of reconversion from war to peace was already under way. After the collapse of Japan in August, the job of unwinding the war economy was greatly accelerated. By the end of the year the physical aspects of reconversion to peace had been virtually completed in this district.

Reshuffling of personnel was quick and comprehensive. Such unemployment as occurred after V-J Day, when huge volumes of Government contracts were canceled, was largely transitional and many workers were reemployed almost immediately on assembly lines set up for peacetime production. Returning veterans replaced women, and new job opportunities opened up rapidly to take the place of many wartime jobs that disappeared. Earlier estimates of transitional unemployment proved to be greatly exaggerated. The various business barometers indicate the speed

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and facility with which readjustments were accomplished at the end of the war.

Transition from war to peace— 1945 (1935-1939 = 100)	War ends August	Post-war slump October	Production for peace December
Third District:			
Industrial production, total.....	144.3	125.6	130.6
Durable goods production.....	240.1	180.4	183.9
Consumer goods production.....	98.7	97.4	106.4
Pennsylvania:			
Employment	108.8	103.5	109.8
Payrolls	197.6	179.3	193.8
Philadelphia:			
Department store sales.....	174.7	184.1	183.8
Cost of living.....	128.4	127.8	128.6

In the closing months of 1945 industrial production in the district was expanding; output of both durable and consumers' goods was increasing. Employment in both manufacturing and nonmanufacturing establishments was growing, payrolls were rising, farm income was being maintained at high levels, and retail trade was surpassing all records. Notwithstanding strikes, threats of strikes, and shortages of labor and materials, business generally stood on the threshold of expanding production and rising consumption.

The Money Supply and Banking

When we turn from the physical aspects of conversion and reconversion to their counterparts in the field of finance, certain contrasts appear. The problems encountered in converting our physical resources to the requirements of war were more difficult and took more time to work out than did the process of gearing our monetary and banking system to meet the money costs of war. Without underestimating the complexity of the financial problem facing any government in wartime, it is still true that there was never any serious doubt that the funds could and would be raised as quickly as they were required. In providing these funds, however, it was necessary to create new money to bridge

the gap between total expenditures and money raised from non-inflationary sources. This new money, created to finance the war, remains with us and creates financial problems that are far more difficult than the physical problems of reconversion. While physical reconversion has been accomplished with a speed that exceeded expectations, little headway has been made in coping with the financial aftermath of war.

The fact that the flow of many goods in greatest demand as yet seems like a mere trickle, although physical facilities are available for producing an avalanche of peacetime goods, is itself largely financial in origin. Labor troubles, which delayed resumption of output in many fields, have revolved principally around the adequacy of money income in the face of rising living costs. Accumulations of money or liquid assets have made it possible for the worker and the employer alike to resist settlement of disputes for protracted periods. Price controls, necessary if this cumulative excess of spending power is to be prevented from sending prices of scarce goods skyrocketing, make producers less willing to accept higher labor costs which cannot be met by raising selling prices, while the price inflation which has already developed makes labor less willing to work for the reduced "take home" pay accompanying the shorter work week normal to peacetime.

An overexpanded money supply, created in meeting the demands of war finance, cannot be cast aside like facilities useful only in producing war goods. Neither could financial commitments of the Government be canceled like war contracts when the war ended. War financing usually continues for some time after the fighting stops, and problems of debt refunding, debt servicing, and monetary control inherited from the war will be with us long after industrial and military demobilization are completed.

War financing

Modern wars have always produced inflationary pressures in the countries which have had to finance their heavy costs. The unique feature of the financial problem facing the United States in World War II lay in the magnitudes involved. The approach to the problem, however, differed from the precedent of previous wars in the more general recognition of inflationary sources of financing, the dangers of which were stressed from the outset.

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It was anticipated that the Government would have to borrow on a huge scale to supplement taxation as a source of funds, and that Government securities could not be sold in the necessary amount without utilizing the resources of the commercial banking system. Efforts were exerted throughout the war period, however, to meet Treasury deficits insofar as possible by borrowing from nonbanking sources. Whether or not the war could have been financed with less inflationary results is open to debate, but certainly there was no lack of frankness in warning the public that to the extent that commercial banks provided the funds needed, inflation of our money supply must follow.

Over the five-year period ending December 31, 1945, the Federal Government spent \$354 billion and added \$24 billion to its cash resources in the general fund. Of this total, \$150 billion was raised from taxes or other current receipts and Government debt was increased by \$228 billion during the same period.

In spite of efforts to utilize other sources of funds, the banking system through purchase or lending against Government securities financed almost \$100 billion, or 44 per cent of the increase in Federal debt. This includes more than \$77 billion increase in commercial bank holdings of Government securities and in loans to purchase or carry such securities, and \$22 billion in additional Government securities absorbed by the Federal Reserve Banks. It is this \$100 billion added to the assets of the banking system that has expanded the money supply, since it was accompanied by an approximately equal expansion in bank deposits and currency combined.

The accompanying table illustrates the close relationship between increased bank holdings of Government securities and the growth in bank deposits or currency. Although other banking changes have exerted some influence on the volume of deposits and currency, they in part offset each other and their combined effect is of relatively minor importance. The most important of these were an increase of \$1 billion in other Federal Reserve credit, minor changes in other loans and investments of commercial banks, and a loss of \$1.9 billion in monetary gold stock.

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Government financing and monetary expansion (Billions of dollars)	Dec. 31, 1940	Dec. 31, 1945	Net change
Government security holdings:			
Commercial banks	\$ 17.8	\$ 90.0	+ \$ 72.2
Federal Reserve Banks	2.2	24.3	+ 22.1
Loans to purchase or carry Governments*3	5.6	+ 5.3
Total	\$ 20.3	\$119.9	+ \$ 99.6
Commercial bank deposits:			
Demand deposits adjusted.....	\$ 34.9	\$ 75.1p	+ \$ 40.2
U. S. Government deposits.....	.8	24.6p	+ 23.8
Time deposits	15.8	30.2p	+ 14.4
Currency outside banks	7.3	26.8p	+ 19.5
Total	\$ 58.8	\$156.7p	+ \$ 97.9

p Preliminary.

* Estimated.

The most striking characteristic of the monetary situation during the war, therefore, has been the close similarity between increases in Government financing by commercial and Federal Reserve banks and the expansion in bank deposits and currency. Omitting time deposits, the table shows an increase of about \$84 billion in the money supply of the country consisting of checking accounts, paper money, and coin.

Federal Reserve credit

At the beginning of 1941, the excess reserves of member banks reached an all-time high of about \$7 billion, largely as the result of the heavy inflow of gold into the United States. Since the latter part of 1943, excess reserves have fluctuated around \$1 billion, rising during war loan drives with the movement of funds from private deposits to reserve-free war loan accounts and falling in the periods between war loans.

Throughout the period, Federal Reserve credit has been expanded as needed to assure ample member bank reserves with the primary objective of keeping adequate bank funds available to meet the requirements of war financing. The principal need for increasing Federal Reserve credit has been to prevent the effect of the \$19½ billion increase in currency demand and an almost \$2 billion loss of gold from reducing member bank reserves.

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Excess reserves were so large at the beginning of the period that very little increase in member bank reserves would have been required if they had been needed only to support the deposit expansion which occurred during the war. Required member bank reserves did not reach the level of total reserves held at the beginning of 1941 until June 1945, and total reserves at the end of 1945 were less than \$1½ billion above January 1941 levels.

Currency and demand deposits Not only has our total money supply increased during the war years, but there has been a marked shift in the relative importance of the two types of money in use—checking deposits and currency. The public determines the ratio between the two, with banks occupying the relatively passive position of accepting currency when offered for deposit and having to pay out currency when requested by depositors. The ratio of currency outside banks to adjusted demand and Government deposits combined, rose from 20.5 per cent at the end of 1940 to about 29.5 per cent at the end of October 1945. This compares with a ratio of approximately 15 per cent in both 1914 and 1930.

The relatively greater reliance of the public on currency during the war period developed from a combination of influences, most important among which have been: (1) the large number of people, including war workers and men in service, removed from localities where they had established banking connections; (2) the use of cash in black market transactions and for purposes of tax evasion; (3) rising prices and increased spending where payments are least likely to be made by check; and (4) the increased proportion of our money supply in possession of those not accustomed to using banks, and its progressive accumulation in holdings of idle money as a result of rapidly expanding payrolls and limited supplies of available consumers' goods. The last factor probably accounts for most of the currency expansion occurring during the war.

Other effects of the war War financing has been the chief cause of three other important changes in the banking picture over the past five years; namely, a great expansion in risk-free earning assets, a marked decline in the ratio of bank capital to deposits, and a rapid increase in net profits. In December 1940, Govern-

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ment securities comprised less than 43 per cent of member banks' earning assets but by the end of 1945 this proportion had risen to 73 per cent. The trend toward low-risk assets also was enhanced by the growing importance of loans against Government securities as collateral and loans guaranteed by Government agencies under the V, VT, T loan programs.

The ratio of capital accounts to deposits of all member banks fell from 10.1 per cent at the end of 1940 to 5.9 per cent in December 1945. Since the primary purpose of bank capital is to protect depositors from the risk of loss through shrinkage of assets, the ratio of capital to deposits is not a satisfactory test of capital adequacy. This ratio is affected by growth in deposits, even though the growth is counterbalanced by growth in risk-free assets. When one compares capital accounts to assets other than Governments and cash, there has not only been no decline but some increase. Of course, no general formula can accurately measure the gradations of risk as between different banks or under changing economic conditions.

Member banks' net profits after taxes rose from 6.2 per cent of capital accounts in 1940 to 10.9 per cent in 1945. A considerable part of the higher net profits of the past three years has resulted from a substantial excess of recoveries and profits on sales over losses and charge-offs. From its very nature, this source cannot be a regularly recurrent item in bank profits. In fact, as long as banks assume risks in their loans and investments they must expect losses to average higher than recoveries in the long run. Although current earnings rose less than profits, they also had reached higher levels relative to capital investment by the end of the war.

Higher earnings have resulted from an overwhelming increase in banks' earning assets which was more than sufficient to offset the effect of declining interest rates and increased expenses. The entire increase in banks' net current earnings is traceable to their participation in war financing, since earnings from sources other than Government securities have actually declined in relation to capital. Banks generally have shown a conservative dividend policy and have applied over two-thirds of wartime profits after taxes to building up capital accounts.

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Although all of these wartime changes are apparent in member banks of the Third District, as well as throughout the country, the accompanying table shows that banking in this district has differed from the average in the degree of change which has occurred. Government securities were relatively less important in banking portfolios in this area before the war, but they made up a larger-than-average percentage of earning assets at the end of 1945. Ratios of capital to deposits at banks in this district remained at higher levels during the war, although this was due in part to the fact that their deposits have expanded less than those of member banks in any other district.

Finally, although the ratio of net profits to capital accounts was less during the war period than at member banks throughout the country, Third District banks have paid out a larger proportion of profits in dividends. A somewhat more liberal, although still conservative, dividend policy might be attributed to the higher capital ratios in this district at the beginning of the war and to the fact that deposits expanded less during the war.

Trends in earnings, capital, and risk-free investments Member banks	Third District		United States	
	1940	1945	1940	1945
Ratio of—				
Government securities to total earning assets, December 31.....	32.6%	75.2%	42.6%	73.1%
Capital accounts to deposits, December 31	14.0	8.2	10.1	5.9
Capital accounts to risk assets, December 31	26.9	36.2	24.9	25.2
Profits after taxes to capital accounts	3.4	10.2	6.2	10.9

Another aspect of bank credit expansion during the war has been the unequal rate of deposit growth in different parts of the country. Over the five years preceding December 1945, deposits of member banks in the Third District increased 96 per cent, as compared with an average increase of 130 per cent in the United States. Principal causes for the relative shift of funds away from

the Northeastern area include: the greater decentralization of wartime industry and rapid development of production in the South and West; heavier expenditures on military facilities and personnel in the same areas; and the rapid rise of income in agricultural regions. The volume of funds raised by the Government over the war period has greatly exceeded expenditures in the Northeast, and Treasury operations have resulted in fairly consistent drains.

With the return to a peacetime economy, some of the influences which have produced interdistrict flow of funds during the war will be ended, and some reversal in the flow may occur during the transition period. The fact that Third District war industries to a large extent were turning out products which required relatively little conversion of plant from peacetime pursuits has simplified their post-war reconversion problems. Some industries required no time for reconversion and many were able to convert to peacetime production within a few weeks.

Its widely diversified production, and particularly the importance of consumers' goods industries such as textiles, should place this district in a relatively strong position for meeting the accumulated demand for civilian goods. It is expected that bank deposits in the Third District will expand, at least during the transition period, even should total deposits of all member banks remain at present levels. If bank credit in general continues to expand, deposits in the Third District may expand at a somewhat faster rate than the average.

Significance for future policies Among the effects of high war incomes and expanding money supply, under conditions which limited civilian spending, has been the unprecedented accumulation of liquid assets by individuals and business concerns. Since 1939, holdings of currency, demand and time deposits, and Government securities have increased \$160 billion, or 246 per cent, according to Federal Reserve estimates. At the end of 1945, personal holdings included \$45 billion in money—both currency and demand deposits—and about \$100 billion in time deposits and Government securities, an important part of the latter being redeemable on

demand. At the same date business held \$43 billion in money and \$37 billion in time deposits and Governments, of which a large part are relatively short-term.

It is estimated that individuals and business concerns in the Third District hold approximately \$13½ billion in liquid assets, divided roughly into \$5 billion of currency and demand deposits and \$8½ billion in time deposits and Government securities.

Since these liquid asset holdings include only actual money or assets which at its own discretion the public can convert promptly into money, they represent a spending potential whose inflationary aspects can readily be recognized. The differentiation between money and other liquid assets is based upon the fact that only the former can be used widely, without further conversion, for purposes of making payments. In this sense time deposits and Government securities are not money, and as long as the public does not exchange them for money they are not inflationary, except as their existence may influence owners to spend more readily.

The distinction is not very important when for any reason the public desires to convert a large quantity of these assets into money. Time deposits of commercial banks in particular are closely related to our money supply. An expansion of commercial bank assets may result in creation of time deposits instead of demand deposits. While time deposits are principally savings accounts and normally are a relatively permanent type of savings, a large part of their increase during the war may be comparable to the accumulation of temporarily idle funds in the form of currency or checking accounts. After very short notice, time deposits may be changed into demand deposits and thus increase our money supply without any increase in bank assets.

As in the case of time deposits, many Government security holdings represent only temporarily idle funds. If the public as a whole desires to reduce its holdings of maturing and redeemable securities, the Treasury must either draw on its working balance or issue new securities. A reduction in the working balance, of

course, increases money in the hands of the public directly. If new securities are issued but are not sold elsewhere, the commercial banking system must be relied upon to bridge the gap as was the case during the war; but this means further monetization of the Government debt.

The conversion of time deposits into demand deposits, and the shifting of Government securities now held by nonbank investors into the portfolios of banks with resulting deposit creation, represent the two most immediate possibilities for a continued increase in our money supply. It is extremely important that further monetary expansion be avoided, and at no time during the war was it more important to encourage nonbank investors to keep their present Government holdings intact and to purchase additional offerings than in the months to come.

The present high currency-to-deposit ratio has several important implications. From the standpoint of the banker, unnecessarily high currency holdings represent potential deposits which might be invested profitably. From the standpoint of inflation, the effect is not so much on the total amount of money as upon the rapidity of turnover. Idle currency holdings may be more conducive than checking accounts to quick spending. Either is apt to be used more freely than savings accounts. In this sense, there would be somewhat less inflationary pressure if part of the saved income represented by currency holdings had been placed in savings accounts.

As long as a large segment of our population uses currency instead of bank deposits or other channels of investment for accumulating savings in substantial amounts, the ratio of currency to deposits not only will be higher than necessary for current transactions but wider fluctuations in the ratio are likely to occur with changes in the income pattern. It will be important to watch the behavior of currency.

It is quite possible that less return flow of currency will develop in the near future than has been anticipated, especially if incomes remain high. Following World War I, the peak of currency ex-

pansion was not reached until two years after the Armistice. Although currency expansion seems to be leveling off, a substantial rise in prices could result in further expansion instead of contraction. The banks themselves can do much to reduce the currency-deposit ratio by encouraging greater use of checking accounts by the public. A lower ratio will be to the long-run advantage of the banking system, and present levels of bank earnings may indicate the desirability of banks re-evaluating their present minimum balance requirements and schedules of service charges. Few changes would reduce currency holding more effectively than lowering the cost of using checking accounts.

The relative decline of bank capital as banking resources expanded during the war raises another problem affecting banks as they plan their peacetime operations. The present high proportion of risk-free assets means that there is little immediate danger from low bank capital ratios, but it is nevertheless true that some individual banks have too little capital and that bank capital on the average is insufficient to support any marked increase in private or risk financing. Although further expansion of bank credit is undesirable under existing inflationary conditions, from the long-run viewpoint it is to be expected that our economy will expand and that banks will be called upon to assume their share of risk financing. Recent offerings of new bank stock have met favorable response from the investing public.

Banking in the Third District may face a regional problem the reverse of that which concerns banks in districts that have expanded most rapidly during the war. If banks in this area gain from the interdistrict flow of funds, as suggested earlier, member bank reserves will expand. Unless such funds are used in absorbing Government securities now held by banks in other areas, they may intensify inflationary pressures locally, particularly if resulting excess reserves are used as a basis for expanding private credit.

As we face the problems of peace, existing monetary and banking conditions hold disturbing implications for the prospects of a stable economy. The war has left us with a redundant supply of money, both in demand deposits and currency, together with huge amounts of other liquid assets which the public can readily

turn into additional money. The banks are in a strong position and there should be little difficulty in financing sound business needs; but if banks assume an increasing volume of Government or private financing, and if consumer and trade credit is used in increasing amounts to finance current transactions, there is grave danger that economic stability, high money income, and the accumulated money savings of the war period will all be dissipated in the quicksands of price inflation.

Prices

Price inflation is a usual consequence of maladjustments growing out of war production and war finance. A lack of balance between goods on hand and money in people's pockets and in deposits at banks creates a price problem of major magnitude. After four years of steady wear and tear without replacement, consumers are clamoring for goods—new automobiles, refrigerators, washing machines, and household appliances of all kinds. Industrial plants also must overhaul, improve, and replace worn out and obsolete capital equipment.

People have money and are willing to spend it. Consumer incomes are being maintained at high levels and buying power is reinforced by enormous wartime savings. Personal holdings of liquid assets—cash, deposits, and Government securities—have expanded about \$100 billion since 1939 to an estimated \$145 billion at the close of 1945. Runaway prices were prevented during the war when inflationary pressures were developing as a consequence of unprecedented expansion in production and war financing.

Inflation is a characteristic of every major war because the production of goods for civilian use does not increase commensurately with the rise in buying power. Inadequate price control added unnecessarily about \$14 billion to the cost of the First World War. It has been estimated that without price control the cost of World War II would have been increased unnecessarily by more than \$80 billion.

Profiting by our former experience, a determined effort was made to hold prices in check. Within five months after our entry

into the Second World War, a comprehensive program was adopted to keep the cost of living from spiraling upward. The program embraced heavy taxation, imposition of price ceilings on commodities and rents, stabilization of wages and prices of agricultural products, rationing of essential commodities, restrictions on credit and instalment buying, and active efforts to sell war bonds to individuals.

The results of these efforts to "hold the line" are revealed by official price indexes. Retail prices of consumers' goods rose only 31 per cent during six years of World War II compared with a rise of twice that amount during the four years of World War I. Wholesale prices rose only 41 per cent during six years of World War II compared with a rise of 103 per cent during the four years of World War I.

In Philadelphia, the wartime rise in prices of consumers' goods paralleled the national changes. Rents rose only 4 per cent, but some other items were more difficult to control. In November 1945 household furnishings were 46 per cent above the August 1939 level, food was up 48 per cent, and clothing 50 per cent; but the index of all consumers' goods and services increased only 31 per cent.

The price problem does not end with the termination of war. Almost half of the inflation generated by the First World War occurred after the Armistice. In view of our former experience, the error of hasty abolition of price controls should not be repeated. Realizing the danger of post-war inflation, the Office of Price Administration last August announced a price policy to stabilize the national economy during the period of transition. The program included the continuation and rigorous enforcement of price controls over food, clothing, rents, and consumers' durable goods not made during the war, but wartime controls over wages were removed.

Efforts to "hold the line" have been under terrific bombardment from all quarters. Industry complains of being caught in a vise between demands for higher wages and the insistence on price ceilings. Labor complains of the squeeze between rising costs of

living and a falling "take home" pay resulting from reduced working hours and overtime pay. The situation is complicated by strikes and threats of strikes which obstruct the flow of goods so urgently needed. Holding the line became steadily more difficult in the closing months of 1945. Wage rates were increased over wide sections of the economy, and numerous price increases were granted in response to irresistible pressure.

A generally higher level of wages and prices is in prospect as a consequence of the recent Wage-Price Stabilization Order issued by the President. Wage increases which have occurred since August 1945 will become the guide for industry-wide advances. Price increases will be allowed where higher wages have serious effects on profits. This realignment of wages and prices, it is hoped, will eliminate the squeeze on labor and industry while avoiding an inflationary spiral until production is adequately increased.

Nevertheless, the basic problem of inflation is the excess of spending power over goods at existing prices. Increasing the flow of goods and services, though necessary, will not in itself solve the problem. The problem of inflation cannot be solved adequately without control over the supply of money and the exercise of restraints by individuals and business concerns over the volume of their expenditures.

The Federal Reserve Bank in the War Years

The work of the Federal Reserve Bank of Philadelphia during the war reflected the basic decision on System policy announced the day after the attack on Pearl Harbor. In effect the decision was that no activity essential to the conduct of the war would be impeded because of lack of funds. The importance of an efficient financial machine and the place of the Federal Reserve System in it were recognized when the System was declared an essential industry in mid-1943.

No policy could be effective until it was executed efficiently. The daily work which occupied each of the Bank's employees during the war years was directed toward fulfilling some part of the over-all task undertaken by the Federal Reserve System.

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Some indication of the sheer size of the job performed by this Bank during the four years succeeding Pearl Harbor may be obtained from figures such as these:

1,765,000,000	coins counted
814,000,000	pieces of currency counted
448,000,000	ordinary checks handled
156,000,000	U. S. Government checks processed
15,000,000	ration checks cleared
6,000,000	collection items (coupons, etc.) handled
80,000,000	pieces issued, redeemed or exchanged by Fiscal Agency Department.

But while statistics give some idea of the millions of man-hours involved, they fail to suggest the problems which had to be solved before the job could be completed. There was the problem of space, which eventually became so acute as to necessitate transferring most of the staff and equipment of the Fiscal Agency Department to new quarters. There also was the problem of machinery and equipment; new card-punching machines, sorters, tabulators, and the like were needed to prevent entire operations from bogging down.

Finally, there was the problem of securing and training the personnel to do the job. In November 1945, early in the Victory Loan Drive, the staff of the Bank reached a peak of 1,740, including those on part time; this compared with about 930 at the end of 1941. One problem of personnel was to obtain a sufficient number of full-time employees. Because of departures for the armed services, to war plants and for other reasons, it was necessary to take on nearly 2,400 people in order to secure a net increase of somewhat less than 500 in the Bank's full-time personnel.

The difficulties of drawing on an ever-tightening labor market meant calling back some employees previously retired because of age, and greatly increasing the proportion of female employees. Bank employees were shifted from one department to another in response to demands for temporary help in completing "rush jobs", but there still was a demand for more personnel which was not satisfied by overtime in most departments. To meet this continuing problem, several hundred part-time and temporary employees were taken on to supplement those working full-time and

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help carry peak loads, particularly during the war loan drives. Students were employed after school hours and during vacation, and men and women who had full-time jobs in war plants and other establishments worked at the Bank after their regular hours.

Rapid turnover complicated the problem of training employees to do work which, in many cases, was new even to experienced personnel. Problems of personnel, together with those of

Federal Reserve Bank of Philadelphia Number of full-time employees	End of		
	1939	1941	1945
Currency and coin.....	78	85	107
Discount and credit.....	40	34	25
Transit and collections.....	247	304	407
Fiscal Agency and RFC custodian.....	54	121	428
Vault, securities—custody.....	28	31	35
Wire transfer.....	7	6	7
Bank examination and bank relations.....	41	43	41
Research, statistics, and library.....	16	22	33
Foreign funds control.....	0	18	5
Consumer credit.....	0	7	6
Secretaries.....	8	9	10
Accounting, general ledger.....	60	51	77
Audit.....	21	16	19
Building and service departments.....	168	186	216
Total.....	768	933	1,416

space and equipment, made difficult the maintenance of efficiency. Nevertheless the volume of work generally rose more rapidly than the number of people performing it, indicating an expansion of output per worker. Problems of operation could not, at any cost, be allowed to impair the quality of the services rendered by the Bank, which contribute so much to the smooth operation of essential business activities. The more efficiently such functions are performed, the more completely they have come to be taken for granted by the general public.

A major policy of war financing was the basis for the bulk of the work of the Fiscal Agency Department. That policy was that nonbank investors should supply as large a proportion as possible of the funds which could not be raised by taxation. The responsibility of Fiscal Agency was to set up and maintain efficient machinery for issuing, redeeming, and exchanging Government

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securities. From the viewpoint of sheer rapidity of expansion, "Fiscal" faced the most difficult problems of any department in the Bank. The growth of the department accounted for almost two-thirds of the expansion of the Bank's full-time personnel from 1941 to 1945. Moreover, many employees from other departments and part-time and temporary help from outside were added during war loan drives.

Assistance was rendered also to the war finance committees in the broader field of selling Government securities to the public. The importance to the economy of financing the war in the most desirable way was emphasized in pamphlets and other literature prepared in the Bank as well as in many discussions by officers throughout the district. Commercial banks were aided in becoming centers of war bond sales in their localities.

Despite intensive efforts to meet war costs as far as possible by taxation and borrowing from nonbank investors, only part was met in this way and commercial banks had to supply the rest. That policy affected the credit and currency operations of this Bank. In order for banks to buy Government securities their reserves had to be maintained, especially against increasing currency demands. This Bank, accordingly, contributed to the extension of Federal Reserve credit by increasing its holdings of Government securities by \$1.4 billion in four years. Most of this was accomplished through participation in the System Open Market Account, but \$219 million represented Treasury bills sold to the Bank under the repurchase option. Discounts and advances accounted for a relatively minor part of Federal Reserve credit extended by this Bank.

Federal Reserve credit was required chiefly to provide the reserves from which to satisfy the public's demand for currency. In the four years 1942-1945 over \$1 billion of the \$17¼ billion increase in circulating currency was in the form of notes of this Bank. In addition to the operations involved in original issue, there was the much greater task of maintaining this huge circulation. Currency repeatedly passes through the Federal Reserve Banks, involving repeated handling: receiving, sorting, counting, reissue, retirement of unfit notes and replacement with new.

The policy of providing funds to war producers, even where risks might exceed those banks were willing to assume, led to the guarantee of loans under Regulation V. Beginning in the spring of 1942 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 that available from normal sources. The process of analyzing and investigating nearly 600 applications for war production and termination loans brought the Credit Department directly into contact with the technical problems of war production and reconversion. Of the total applications, 443 were approved and had guarantees executed. More than one-third of the approved applications were approved directly at this Bank.

The Transit Department also made a major contribution to a smoothly functioning wartime economy. In addition to clearing almost half a billion checks used by business and individuals to carry on day-to-day business transactions, the department handled over 150 million Government checks. This Bank was given the responsibility of sorting all Army allotment checks in the United States, and with the tremendous expansion of the Army came increasingly difficult problems of handling allotment checks. The peak came in March 1945, when 4,600,000 checks were received and processed in a single month. Another special wartime function was the clearing of ration checks. The millions of ration checks handled by "Transit" represented an essential part of the task of allotting equitably huge quantities of meats, sugar, gasoline, and other scarce materials.

Two other functions of the Bank which arose directly out of the war situation involved control over the use of credit in consumer purchases and over foreign funds. Consumer credit control under Regulation W, designed to restrict consumer demand by limiting the creation of credit in the distribution of consumers' goods, was undertaken in September 1941 and extended in May 1942. It applied to all those extending instalment sale and charge credit or instalment cash loans to consumers. The Consumer Credit Department of this Bank was responsible for administering Regulation W throughout the Third District, including registration of 12,000 credit grantors coming under its provisions. The

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work of the department consisted not only of interpreting and enforcing the various rules and regulations, but also of educating business and the public as to the importance of consumer credit control. The fact that the regulation was enforced without sacrifice of good will testifies to the effectiveness of the educational campaign.

The control of foreign funds for the United States Treasury was an integral part of economic warfare. The control was established by Executive Order in April 1940, following the German invasion of Norway and Denmark. As the Axis powers overran one country after another, the control was extended to the assets of the Netherlands, Belgium, France, and the Baltic and Balkan states. By mid-1941 practically all of continental Europe was included under the control, as were Japan and China. Immediately after Pearl Harbor the Bank cooperated with the various Government enforcement agencies in investigating and compiling records of approximately 150 persons and firms of Japanese nationality.

Over a period of about five years the Bank received and processed nearly 18,000 applications for licenses to carry on foreign transactions. In assisting the Treasury to take censuses of foreign holdings in this country and United States interests in foreign countries, the Foreign Funds Department processed over 30,000 reports. As its work progressed, the department gradually was accorded a large share of responsibility. In the later years approximately 80 per cent of all applications could be handled without the necessity of referring them to the Treasury Department.

The Research Department continued to compile important information on significant developments and to prepare analytical memoranda to assist in the formulation of policies. It also devoted much time to the problems of the transition to peace. One phase of this work was the preparation and publication of a series of basic studies on the economy of the Third Federal Reserve District. Another phase was a thorough study of prospects of the Philadelphia area with a view to facilitating the transition to high levels of peacetime production and employment. Several surveys were conducted in cooperation with the local Committee for Economic Development. Industrial forums were held on the basis of these surveys and detailed analyses of important industries

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of the area. Leaders in these industries attended the meetings to discuss their post-war problems and to develop programs to meet them.

Another phase of the Bank's activities included discussions with bankers. During 1945, two meetings of the Federal Reserve Relations Committee were held at the Bank—one in January and the other in October. The Committee, which consists of 28 members representing regional banking groups in this district and the presidents and secretaries of the three state banking associations covered by the district, met with officers of this Bank to discuss banking, credit, and other problems of common interest. These discussions were transcribed and later distributed to all banks in the district. Moreover, members of the Committee reported at annual and interim meetings of their respective regional groups and in numerous cases to county groups. The Committee has provided an effective medium for fostering better understanding and closer relationships between this Bank and the banks in the district generally.

In addition to meetings of the Federal Reserve Relations Committee, members of the Bank's staff participated in numerous meetings of bankers in various localities throughout the district and in forums conducted by the American Institute of Banking. In the year 1945 alone, the officers of the Bank participated in more than 600 meetings and conferences.

Directors and officers In the annual election of directors George W. Reily, President of the Harrisburg National Bank, Harrisburg, Pennsylvania, was re-elected by member banks in Group 2 as a Class A director, and Albert G. Frost, President of Esterbrook Steel Pen Manufacturing Company, Camden, New Jersey, was elected by member banks in Group 3 as a Class B director to succeed Ward D. Kerlin, who after serving two terms asked that his name not be included among the candidates for election. Thomas B. McCabe was reappointed by the Board of Governors as a Class C director, beginning his new term January 1, 1946. Mr. McCabe served as Chairman of the Board and Federal Reserve Agent and Warren F. Whittier as Deputy Chairman during 1945; both were reappointed for 1946.

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The Board of Directors appointed David E. Williams, President of the Corn Exchange National Bank and Trust Company, Philadelphia, as a member of the Federal Advisory Council for the year 1946. Mr. Williams succeeds William Fulton Kurtz, President of the Pennsylvania Company for Insurances on Lives and Granting Annuities, Philadelphia.

Several developments took place in the official staff early in 1946. Alfred H. Williams was re-elected President of the Bank for a term of five years, beginning March 1, 1946. The directors accepted with deep regret the resignation, effective February 28, 1946, of Frank J. Drinnen, First Vice President of the Bank for ten years. He was succeeded by W. J. Davis, who has been with the Bank since 1917 and has been a Vice President since 1936. William G. McCreedy was appointed a Vice President of the Bank. Mr. McCreedy has been associated with the Bank since 1915, having served successively as Comptroller and Assistant Vice President. He continues as Secretary. On January 1, 1946, Philip M. Poorman, formerly General Auditor, succeeded C. A. McIlhenny as Cashier. Norman G. Dash was appointed General Auditor.

William D. Cobb, Assistant Cashier, and for many years head of the Transit Department, retired at the end of 1945. James V. Vergari, formerly head of the Consumer Credit Department, and Robert R. Williams, who had been on leave of absence in the military service of the United States, were appointed Assistant Vice Presidents.

The appendix, beginning on page 35, contains the following tables:

Statement of condition
Profit and loss account
Volume of operations
Applications for industrial loans
Member bank reserves
Changes in member bank reserves and related items
Loan drive sales
Combined statement of member banks
Earnings and expenses of member banks

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*Directors
as of January 1, 1946*

Class A:	<i>Group</i>	<i>Term Expires December 31</i>
Howard A. Loeb..... Chairman, Trademans National Bank and Trust Company, Philadelphia, Pennsylvania.	1	1947
George W. Reily..... President, Harrisburg National Bank, Harrisburg, Pennsylvania.	2	1948
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
Charles A. Higgins..... Chairman and President, Hercules Powder Company, Wilmington, Delaware.	2	1947
Albert G. Frost..... President, Esterbrook Steel Pen Manufacturing Company, Camden, New Jersey.	3	1948
 Class C:		
Thomas B. McCabe, Chairman and Federal Reserve Agent President, Scott Paper Company, Chester, Pennsylvania.		1948
Warren F. Whittier, Deputy Chairman..... Chester Springs, Pennsylvania.		1946
C. Canby Balderston..... Dean, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia, Pennsylvania.		1947

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Officers

as of March 1, 1946

ALFRED H. WILLIAMS, *President*

W. J. DAVIS,
First Vice President

L. E. DONALDSON,
Assistant Vice President

C. A. McILHENNY,
Vice President

ROBERT N. HILKERT,
Assistant Vice President

ERNEST C. HILL,
Vice President

JAMES V. VERGARI,
Assistant Vice President

C. A. SIENKIEWICZ,
Vice President

ROBERT R. WILLIAMS,
Assistant Vice President

WILLIAM G. MCCREEDY,
*Vice President
and Secretary*

KARL R. BOPP,
Director of Research

PHILIP M. POORMAN,
Cashier

WALLACE M. CATANACH,
Assistant Cashier

NORMAN G. DASH, *General Auditor*

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Statement of Condition

Federal Reserve Bank of Philadelphia (000's omitted in dollar figures)	December 31		
	1943	1944	1945
RESOURCES			
Gold certificates	\$1,029,794	\$ 945,229	\$ 878,051
Redemption fund—Fed. Res. notes.....	24,120	42,799	61,134
Total gold certificate reserves.....	\$1,053,914	\$ 988,028	\$ 939,185
Other cash	24,499	17,815	15,576
Discounts and advances.....	700	505	4,386
Industrial loans	4,046	2,570	1,763
United States Government securities.....	861,738	1,252,245	1,610,468
Total loans and securities.....	\$ 866,484	\$1,255,320	\$1,616,617
Due from foreign banks.....	13	12	10
Fed. Res. notes of other F. R. Banks.....	4,620	4,042	7,298
Uncollected items	117,062	153,977	139,850
Bank premises	3,600	3,457	3,313
All other resources.....	4,815	3,278	4,353
Total resources	\$2,075,007	\$2,425,930	\$2,726,202
LIABILITIES			
Federal Reserve notes.....	\$1,149,726	\$1,427,510	\$1,635,242
Deposits:			
Member bank reserve account.....	645,809	710,778	799,634
U. S. Treasurer—general account.....	31,375	28,722	59,678
Foreign	120,273	106,353	72,195
Other deposits	5,351	4,578	4,308
Total deposits	\$ 802,808	\$ 850,431	\$ 935,815
Deferred availability items.....	84,031	105,809	106,130
Other liabilities	875	613	500
Total liabilities	\$2,037,441	\$2,384,363	\$2,677,687
CAPITAL ACCOUNTS			
Capital paid in.....	\$ 11,686	\$ 12,227	\$ 13,064
Surplus—Section 7	17,859	19,872	28,946
Surplus—Section 13b	4,421	4,468	4,501
Reserves for contingencies.....	3,600	5,000	2,004
Total liabilities and capital accounts....	\$2,075,007	\$2,425,930	\$2,726,202
Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities com- bined	54.0%	43.4%	36.5%
Commitments to make industrial advances....	\$1,930	\$3,048	\$703

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Profit and loss account Federal Reserve Bank of Philadelphia (000's omitted)	1943	1944	1945
Earnings from:			
United States Government securities.....	\$5,122	\$7,275	\$9,929
Other sources	217	165	134
Total earnings	\$5,339	\$7,440	\$10,063
Expenses:			
Operating expenses*	\$2,498	\$2,827	\$3,007
Cost of Federal Reserve currency.....	409	524	349
Assessment for expenses of Board of Gov- ernors	229	211	204
Total net expenses.....	\$3,136	\$3,563	\$3,560
Current net earnings.....	\$2,203	\$3,877	\$6,503
Additions to current net earnings:			
Profit on sales of U. S. Government securi- ties	\$2,928	\$ 263	\$ 256
Transfers of reserves in excess of require- ments	100	86	150
Other additions	13	41	52
	\$3,041	\$ 390	\$ 458
Deductions from current net earnings.....	1,642**	4	5
Net additions to current earnings.....	\$1,399	\$ 386	\$ 453
Net earnings available for distribution.....	\$3,602	\$4,263	\$6,956
Distribution of net earnings:			
Paid to Treasury of United States, Sec. 13b	\$ 84	\$ 84	\$ 84
Dividends paid to member banks.....	701	719	766
Transferred to surplus (Sec. 13b).....	28	47	32
Transferred to surplus (Sec. 7).....	2,789	3,413†	6,074††

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

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

† \$1,400,000 transferred to Reserves for Contingencies.

†† \$3,000,000 also transferred to Surplus from Reserves for Contingencies.

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Volume of operations Federal Reserve Bank of Philadelphia	1943	1944	1945
Pieces or transactions handled (000's omitted)			
Discounts and advances.....	1	1	1
Currency counted	200,093	209,594	208,611
Coins counted	433,502	437,431	474,170
Ordinary checks	110,713	112,036	115,501
Checks handled in packages by automobile run service	17,608	16,320	17,321
U. S. Government checks (including Treasury card checks first handled in 1943).....	23,389	52,426	70,155
Work relief checks	0	0	0
Ration checks	4,993	5,275	5,041
Collection items:			
Coupons of U. S. Government and agencies.....	1,214	1,299	1,373
All other (notes, drafts and coupons).....	212	185	180
Transfers of funds.....	62	63	65
Issues, redemptions, and exchanges by Fiscal Agency Department:			
U. S. Government direct obligations.....	19,717*	25,479*	26,756*
All other	4	36	22
Dollar amounts (000,000's omitted)			
Discounts and advances.....	\$ 327	\$ 509	\$ 1,184
Currency counted	1,015	1,077	1,178
Coins counted	40	41	44
Ordinary checks	43,593	45,548	47,441
U. S. Government checks (including Treasury card checks first handled in 1943).....	6,723	8,188	8,401
Work relief checks.....	0	0	0
Collection items:			
Coupons of U. S. Government and agencies.....	78	103	131
All other (notes, drafts, and coupons).....	224	243	260
Transfers of funds.....	7,158	8,424	9,032
Issues, redemptions, and exchanges by Fiscal Agency Department:			
U. S. Government direct obligations.....	8,014*	9,788*	8,686*
All other	17	110	110
Securities held in custody for member banks at end of year.....	\$1,651 mil.	\$1,921 mil.	\$2,207 mil.
Savings bonds in safekeeping at end of year (number of pieces).....	133,000	229,000	303,000

* Includes savings bonds sold through other issuing agents, and redemptions through qualified commercial banks.

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Applications for industrial loans Federal Reserve Bank of Philadelphia	1945	June 30, 1934- December 31, 1945
Number		
Approved	12	365
Rejected	0	457
Withdrawn	2	70
Under consideration	0	0
Total number	14	892
Amount		
Approved	\$2,155,000	\$61,796,426
Rejected	0	17,126,350
Withdrawn	21,000	4,012,700
Under consideration	0	0
Total amount	\$2,176,000	\$82,935,476

Member bank reserves Third Federal Reserve District (Dollar figures in millions)	Actually held	Required	Excess	Ratio of excess to required
Philadelphia banks:				
1942: Jan. 1-15.....	\$449	\$294	\$155	53%
1943: Jan. 1-15.....	418	358	60	17
1944: Jan. 1-15.....	370	357	13	4
1945: Jan. 1-15.....	388	374	15	4
1946: Jan. 1-15.....	423	411	12	3
Country banks:				
1942: Jan. 1-15.....	224	145	79	55
1943: Jan. 1-15.....	256	184	72	39
1944: Jan. 1-15.....	272	215	57	26
1945: Jan. 1-15.....	316	247	69	28
1946: Jan. 1-15.....	379	297	82	28
All members:				
1942: Jan. 1-15.....	673	439	234	53
1943: Jan. 1-15.....	674	542	132	24
1944: Jan. 1-15.....	642	572	70	12
1945: Jan. 1-15.....	704	621	84	14
1946: Jan. 1-15.....	802	708	94	13

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Changes in member bank reserves and related items Third Federal Reserve District (Millions of dollars)	1943	1944	1945
Sources of funds:			
Reserve Bank credit extended in district.....	+210	— 31	+ 39
Interdistrict commercial transfers.....	+846	+1,053	+944
Mint gold purchases, net.....	+ 0	— 0	— 1
Treasury operations	—755	— 676	—660
Total	+301	+ 346	+322
Uses of funds:			
Currency demand	+305	+ 281	+232
Member bank reserve deposits.....	— 6	+ 65	+ 89
"Other deposits" at Reserve Bank.....	+ 1	— 1	— 0
Other Federal Reserve accounts.....	+ 1	+ 0	+ 1
Total	+301	+ 346	+322

Loan drive sales in 1945 (Dollar amounts in millions)	Third Fed. Res. Dist.	United States	% Third Dis- trict of U. S.
Investor class:			
Individuals, partnerships, and personal trusts	\$ 975	\$15,457	6.3
Savings banks	228	4,011	5.7
Insurance companies	339	7,288	4.7
Brokers and dealers	7	596	1.2
State and local governments and their agencies	279*	3,318	8.4
All other (nonfinancial corporations, associations, etc.).....	785	16,787	4.7
Total	\$2,613*	\$47,457	5.5
E bonds (included above in sales to individuals)	341	6,180	5.5
Total sales to nonbank investors:			
First Drive	\$ 335	\$ 7,860	4.3
Second Drive	659	13,476	4.9
Third Drive	934	18,944	4.9
Fourth Drive	856	16,730	5.1
Fifth Drive	1,003*	20,639	4.9
Sixth Drive	1,065*	21,621	4.9
Seventh Drive	1,488*	26,313	5.7
Victory Drive	1,125*	21,144	5.3
Total all drives.....	\$7,465*	\$146,727	5.1

* Including proportionate share of purchases by Commonwealth of Pennsylvania, which in the last four drives were not allocated by counties.

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All member banks Third Federal Reserve District (Millions of dollars)	Dec. 31, 1945	Percent change from		Percent distribution	
		Dec. 30, 1944	June 30, 1939	Dec. 31, 1945	June 30, 1939
Assets					
Loans and discounts.....	934	+ 15.6	+ 1.5	12.7	26.3
U. S. Government obligations.....	4,357	+ 20.7	+481.7	59.3	21.4
Other securities	507	+ 26.8	- 19.1	6.9	17.9
Cash assets	1,456	+ 14.0	+ 45.6	19.8	28.6
Fixed assets	70	- 16.7	- 60.7	.9	5.1
Other assets	27	+ 12.5	+ 8.0	.4	.7
Total	7,351	+ 18.5	+110.1	100.0	100.0
Liabilities and capital accounts					
Deposits:					
Individuals, partnerships, and corporations—					
Demand	3,379	+ 14.3	+ 169.5	46.0	35.8
Time	1,542	+ 24.1	+ 44.9	21.0	30.4
U. S. Government.....	1,135	+ 31.8	+1,219.8	15.4	2.5
Bank	438	+ 10.3	+ 14.4	5.9	10.9
Other	269	+ 28.1	+ 35.2	3.7	5.7
Total deposits	6,763	+ 19.3	+ 126.5	92.0	85.3
Other liabilities	32	+ 28.0	+ 52.4	.4	.6
Capital accounts	556	+ 8.8	+ 13.0	7.6	14.1
Total	7,351	+ 18.5	+ 110.1	100.0	100.0

Earnings and expenses Third District member banks (Millions \$)	1942	1943	1944	1945 (prelim.)
Total earnings:				
On securities	44.0	53.3	64.2	75.9
On loans*	42.2	35.2	32.5	31.7
Other	21.5	22.1	23.1	23.9
Total	107.7	110.6	119.8	131.5
Current expenses:				
Salaries and wages	30.2	30.9	32.2	34.8
Interest on deposits.....	10.6	9.7	10.2	12.2
Other	28.1	29.7	29.8	32.2
Total	68.9	70.3	72.2	79.2
Net current earnings	38.8	40.3	47.6	52.3
Net charge-offs (-) or recoveries and profits on sales of securities (+) ..	-17.9	- 4.8	- 2.4	+16.4
Taxes on net income.....	2.9	5.0	8.8	13.9
Net profits	18.0	30.5	36.4	54.8
Cash dividends declared.....	15.9	15.8	16.4	17.8

* Includes service charges and fees on loans.