EARLY FRUITS OF VICTORY

Thirty-second Annual Report

of the

FEDERAL RESERVE BANK

OF PHILADELPHIA

1946

Third Federal Reserve District

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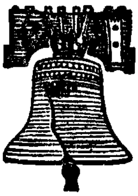

1946

Third Federal Reserve District

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FEDERAL RESERVE BANK
OF PHILADELPHIA

April 30, 1947.

To the Member Banks in the
Third Federal Reserve District:

This Thirty-second Annual Report of the Federal Reserve Bank of Philadelphia reviews developments in business and banking during the post-war period. Entitled the "Early Fruits of Victory," it deals particularly with the diverse problems of the period and the manner in which they are being met.

ALFRED H. WILLIAMS
President.

EARLY FRUITS OF VICTORY

For more than a year since V-J Day the American economy has shown conflicting movements that on balance emphasize inflationary pressures. Diversity of action as well as confusion of counsel in many quarters has tended to obscure the meaning of the victory that has been achieved at such heavy cost. But if we sink our shafts of thought below the surface, these appearances acquire a constructive significance of fundamental importance. We need only remember earlier periods of war and reconstruction to recall that apparent impairment of the unity of purpose and effort that made victory possible is an immediate consequence of military defeat of a powerful foe. Developments since the end of the Second World War show just about the usual manifestations that accompany the complex transition of the economy from wartime to peacetime activities.

It need occasion no surprise that conflict seems to be the order of the day in this country. Cleavages of objectives and desires are inherent in every human society. A fundamental distinction between democracy and dictatorship is the attitude toward such differences in aims, purposes and desires. Democratic societies foster and encourage personal and independent views. Each member is free to enter his ideas in competition with those of his fellows. The only requirements are that in political life he submit to the decision of the majority and that in economic life he yield to the decision of the market place operating under democratically established rules of conduct. An immediate decision, of course, may be wrong; but when the majority so decides, they may change it. Variety of ideas gives strength, resilience, and adaptability to democratic institutions as well as significance, color and zest to the lives of democratic citizens. Differences of opinion are the basis for progress and are the very tissue of democratic society.

In a dictatorship, on the other hand, differences of opinion are not tolerated. The State alone determines both the goals of society and the means of achieving them. Those suspected of disagreement are "liquidated." In an attempt to promote the notion that the State is omniscient and thus is infallible, programs may be continued even after it becomes obvious that they are based on error in conception and judgment.

The apparent unity of dictatorships and the apparent disunity of democracies are often misinterpreted as demonstrations of strength and weakness. Twice within a generation dictators have made this mistake. Both instances have proved that the citizens of democracy are after all united on a basic principle. They agree on the right of each member to his own opinion, on the right to disagree. They will defend that right with their lives and fortunes. They even submerge actual disagreements on important but obviously lesser matters in defense of this basic principle. Democracies are strong in war because each citizen is defending for himself what all citizens of a dictatorship are defending only for the State.

When war is in progress, rights tend to be submerged and duties emphasized. It is understandable that citizens of a democracy want to make sure after defeat of an external enemy that they have indeed won the victory. They want to know with certainty that they can exercise the fundamental right to disagree. The final test, of course, is to disagree in fact. The first full year of peace has brought conclusive evidence in this respect that victory has been real. The present ferment, therefore, may well presage greater strides of democratic progress, just as it did after the Civil War.

Our future is neither assured nor determined. During the war we demonstrated our ability to discharge responsibilities. Since the end of the war we have been busily reasserting our rights. In the long run, however, continued progress depends on achieving and maintaining proper balance between rights and duties.

Conferences with bankers Informed discussion is always an essential ingredient of the democratic process. Exchanges of views are particularly important in periods of fundamental changes and consequent readjustment to new conditions. Conscious of its responsibility as well as opportunity for service in this district, this Bank has developed a program of conferences with the bankers in the field in an attempt not only to discuss current problems of mutual interest but also to seek solutions to these problems through cooperative efforts.

The first step in the program was to intensify the work of the Federal Reserve Relations Committee. This Committee had been formed originally some twenty years ago primarily to discuss technical aspects of the relation between the Federal Reserve Bank and the commercial banks of the district. The Committee was revitalized in 1945 to discuss broader aspects of business, banking, and credit developments.

Two all-day meetings were held at this Bank in 1946: one on May 17 and the other on October 18. Participants included twenty-six members elected or appointed by bank groups and state associations representing some 900 banks in this district. Also present were the principal officers of state bankers' associations and officers of this Bank.

Agenda were carefully planned and outlined. Included in the discussion were such subjects as developments in lending and investment; bank operating problems, with particular emphasis on sources of earnings and factors of cost; and developments in controlling inflationary pressures, with special reference to the debt retirement program of the Treasury, private credit expansion, and credit control proposals as outlined in the Board of Governors' Annual Report for 1945. The results of these discussions were printed in booklets, copies of which were sent to all banks in the district. Over the years these records should provide valuable history of contemporary thinking on banking and credit in this district.

The second step in the program has been the development of field conferences for the interchange of ideas with small groups of executive bank officers, one from each bank. These groups range in size from ten to thirty, with an average of about twenty bankers. About forty such conferences have been held, covering all counties in the district. Where counties were relatively small, two or more were combined into one group.

These field conferences were organized largely on the basis of the discussions at the meetings of the Federal Reserve Relations

Committee but with particular emphasis on local conditions. At least four officers of this Bank participated in each of these conferences. A senior officer acted as moderator and kept the discussion within the general framework outlined in advance. All officers of this Bank have participated and staff members have attended most of the meetings. Under a cooperative arrangement with the Pennsylvania State College, county farm agents, and frequently the director of agricultural extension or his assistants also participated.

The underlying idea of these field conferences and that of meetings of the Federal Reserve Relations Committee has been to provide an opportunity for intimate discussion of banking and credit problems by a limited number of executive bank officers. The primary objective of these conferences has been to stimulate discussions and factual analyses as essential steps in searching for solutions of the problems in the light of changing conditions in the economy. In developing each discussion an attempt was made to bring out the experiences and views of each participant both on difficulties common to the group and on broader problems affecting banking and credit.

The initial response to these conferences has been beyond expectation. It shows that the broadened program of bank and public relations fills a void that has apparently been growing over the years. Requests for continuing the field meetings are most encouraging particularly as they indicate that the program is both well conceived and workable. This outcome is gratifying, and at the same time it imposes heavy responsibilities upon the officers of this Bank to encourage and carry on free discussion and interchange of ideas in mutual confidence.

Business Conditions in 1946

The clash of interests and opinions was reflected in all segments of the economy. Production, prices, and income felt their impact. Opposing groups sought to make their influences felt by both political and economic means, and the progress of transition was retarded by a welter of conflicting arguments and opposing sets of "facts." By comparison, the physical problems of reconversion — the redesigning of products and the assembly of tools — were easy. For most industries reconversion was accomplished by the first quarter of the year. The controversies over wages and prices, however, continued bitter and voluminous.

The clash over wages The industrial disputes of early 1946 had their origin in the events which transpired immediately after V-J Day. The curtailment of munitions production had caused gross weekly earnings in manufacturing industries to drop from an average of $47.50 at the beginning of 1945 to $40.87 in September. Labor wanted to maintain its "take home" pay; management, faced with reconversion difficulties of an unpredictable nature, held that wages could not be raised without raising prices.

The decision to free wages from Government control and the abolition of the War Labor Board almost immediately after V-J Day precipitated a long series of industrial disputes which resulted in what was later known as the "first round" of wage increases. It began with the work stoppage in the oil refineries which led to their seizure by the Government.

It was the General Motors strike which began late in November 1945 that set the pattern for wage negotiations early in 1946. The fact-finding board appointed by the President investigated the dispute and recommended a 17½ per cent wage boost. There was no settlement at that time, however, and late in January the workers in the steel, electrical manufacturing, meat packing, and farm equipment industries went on strike. One and one-half million workers were directly involved in these disputes, and many more were indirectly affected by the stoppage of parts and material flow through the industrial machine. Production in the Third Federal Reserve District, which seemed to be making a recovery from the low point reached in October, dropped nearly 20 percent in February owing to a sharp decline in durable goods output. The production of consumers' goods was not affected by the strikes, and production in those lines hit a record high in February.

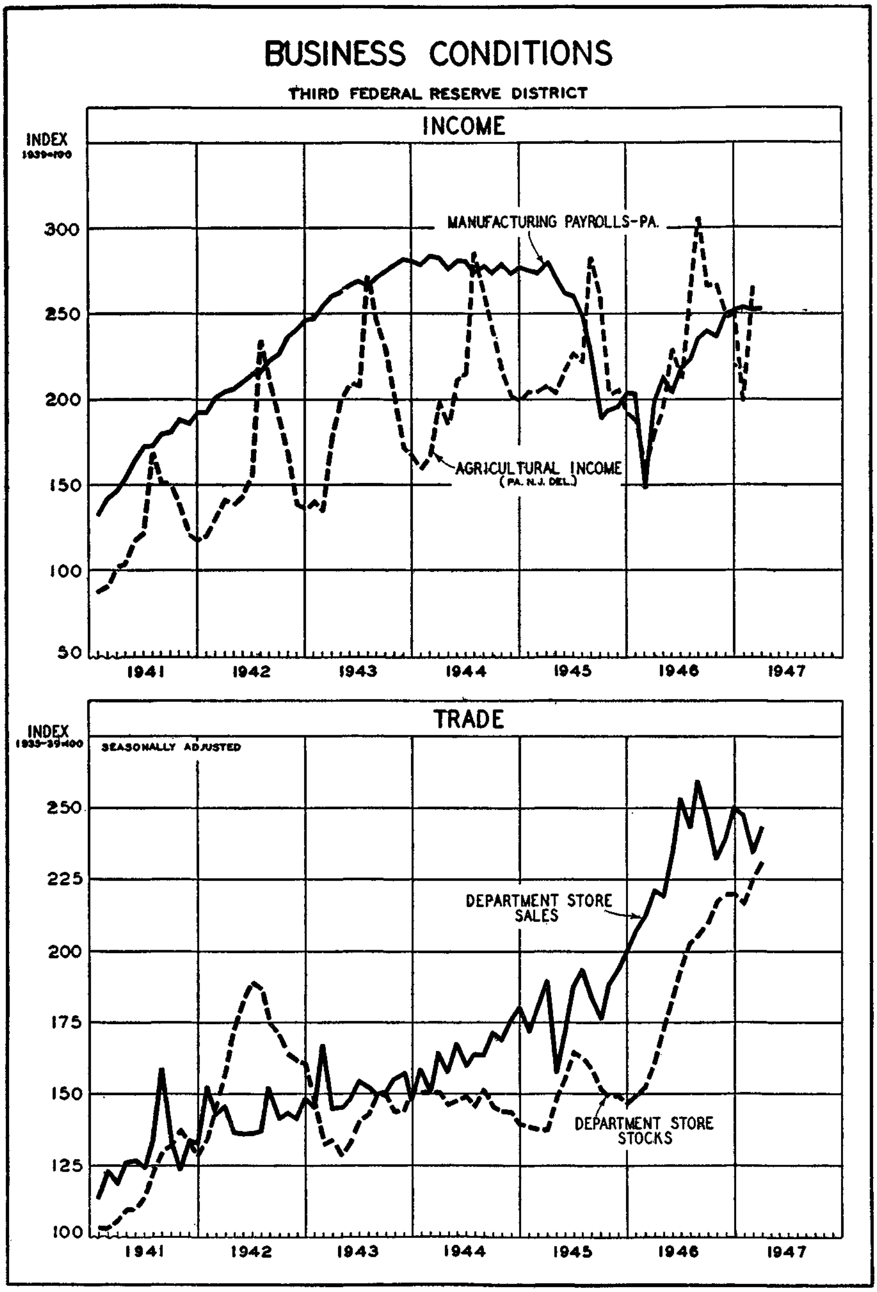
The crisis in production resulted in the issuance of Executive Order 9697 — the Wage-Price Stabilization Plan of February 14.

Additional Government controls were established over wages, but increases in pay were to be permitted in accordance with the numerous precedents which had been set throughout industry in the previous months. Price increases were to be permitted to the extent necessary to offset increased labor costs. The steel dispute was immediately settled on the basis of this plan, and this, together with other recommendations of a fact-finding board, became the basis for the settlement of scores of strikes. It was hoped that the realignment of wages and prices on a slightly higher level would correct inequalities and distortions which had developed and would make it possible to stave off a wage-price spiral until production could be increased sufficiently to meet existing demands.

Industrial production recovered somewhat in March but the bituminous coal strike, which lasted for almost two months, sent it down again in April and May. An anthracite strike of seven days' duration took place in June, but by the end of that month the "first round" of industrial disputes had been about completed and durable goods production moved upward. In July, factory employment in Pennsylvania rose to its highest point since the beginning of the year, though it remained considerably below the average for 1945.

The clash over prices During the first half of 1946 there was increasing controversy over price control. Its proponents said it was necessary to continue it in order to keep the gap between money supply and goods from causing a runaway inflation. Its opponents pointed to distortions in the structure of prices and to the need for encouraging production by price increases. Both sides wanted to do away with price control as soon as possible. Everyone agreed that its retention would be incompatible with the free peacetime economy which we were trying to reestablish. But there was considerable disagreement as to the timing of its discontinuance. Price revisions permissible under the existing regulation allowed wholesale prices to advance 5 percent from January to June, and the consumers' price index for Philadelphia rose from 129 to 133 percent of the 1935-1939 average.

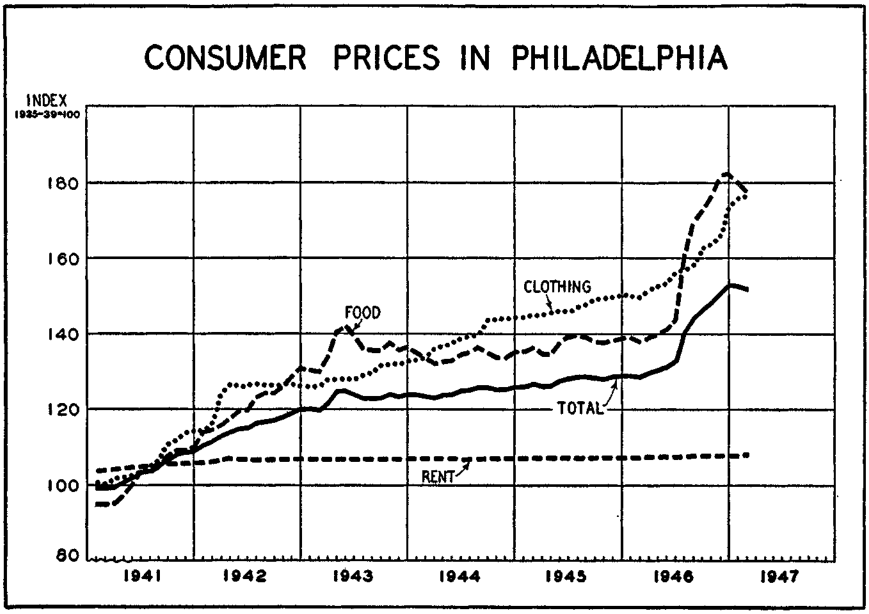
The controversy culminated in the lapse of price control after the President's veto of a modified extension bill late in June. Dur-


BUSINESS CONDITIONS
THIRD FEDERAL RESERVE DISTRICT
INCOME
INDEX 1939=100
300
250
200
150
100
50
MANUFACTURING PAYROLLS-PA.
AGRICULTURAL INCOME (PA. N.J. DEL.)
1941
1942
1943
1944
1945
1946
1947
TRADE
INDEX 1935-39=100
SEASONALLY ADJUSTED
250
225
200
175
150
125
100
DEPARTMENT STORE SALES
DEPARTMENT STORE STOCKS
1941
1942
1943
1944
1945
1946
1947

ing the three-week price holiday that ensued, prices rose rapidly. They were not effectively harnessed by the compromise price control extension bill that was passed in July. Lifting of controls on meat and acceleration of the removal of ceilings on other products in October presaged an early end to all price regulation. It came on November 9—seven months before the statutory limit. Sugar, rice, and rents were the only items over which the Government retained control. By the end of the year, wholesale prices had attained a level of 175 or one-third above the previous year. The cost of living in Philadelphia had risen to 153 per cent of the 1935-1939 average.

Remaining wage controls, since they were closely connected to prices, were also abandoned. Faced with a sharp rise in the cost of living, organized labor indicated its intention of asking for more. While the interim between July and November was relatively free of strikes, the coal dispute which started in the latter month was especially significant because it was apparently the beginning of a "second round" of major wage increase demands. With many other union contracts subject to early renegotiation, the coal settlement could have been a very important precedent. After legal action had been started against the coal miners, the strike was called off and its settlement postponed. Negotiations for adjustments of wage demands in other industries proceeded smoothly, and the month of December had the lowest level of strikes since the end of the war. Production in this district, at 142 per cent of the 1935-1939 average, exceeded the 1941 level for the first time since V-J Day. The rate of recovery in industrial production for the district was somewhat behind that for the rest of the country because of a marked decline in wartime shipbuilding.

While the issue of still higher wages was debated vigorously both in the press and on the platform, organized labor in leading industries did not press for a second round of wage increases. Attitudes of labor leaders were undoubtedly tempered by the prospect of unfavorable Congressional action and the danger of a business recession. A slump in business activity had been widely forecast in a series of predictions from many sources since the stock market slump in September. Management on its part, perhaps tempered by rising profits, was conciliatory.



Whatever the reasoning behind it, at the end of the year both sides had apparently come to the realization that a continuation of the wage-price spiral of the spring and summer and repeated interruptions of production would have unfavorable consequences for all. The possibility of serious strikes remained, but we learned a great deal from our experience during 1946. The first fruits of victory in labor-management relations may well have been in the form of a lesson in making democracy work.

Developments in the first quarter of 1947 bore out this hope. Unlike the early months of 1946, when at one time 1½ million workers were out on strike, few strikes of more than local importance occurred. Labor-management relations were marked by increasing moderation and restraint, and major issues were resolved without work stoppages.

An entirely different business climate prevailed early in 1947. Business had became reaccustomed to operation without Government controls and the public had been reacclimated to the exercise of choice in free markets. Negotiations with respect to price changes were not necessary. Problems of physical reconversion were passé. A smoother flow of production, growing efficiency, and an increased ability on the part of management to plan ahead allowed for greater leeway in wage negotiations. Aided by favorable tax revisions, over-all earnings in trade and industry were relatively high. As it became generally apparent that earnings, with few exceptions, had been substantially higher in 1946 than the preceding year, management was inclined to grant wage concessions.

Although a second round of wage increases began during the first quarter of 1947, wage rates were already high as measured by past standards. Consumption had not declined noticeably, and the dearth of purchasing power which some feared might cause a recession was not clearly in sight. Labor was therefore inclined to moderate its demands. In a statement to the press, however, the President emphasized the need for higher wages if rising prices continued to cut into purchasing power. On the other hand, many business men still held to the view that any wage increase would necessitate proportionate increases in prices. Rapidly rising prices rekindled the conflict.

But the most important factor of all in the situation, which made for a smoother running economy at the outset of 1947, was the fact that the experience of the previous year was well remembered. People remained conscious of the danger involved in continuing the wage-price spiral, and no one wanted to repeat the production losses which occurred in the first half of 1946. In this atmosphere collective bargaining seemed to take an encouraging turn in the process of settling industrial disputes. Production of goods and services was maintained at high levels.

Jobs for all In the first full year of peace practically all of our human and material resources were being used, and cash registers rang up a new retail trade record. National income consisting of money payments to labor and capital employed in production amounted to $165 billion, which surpassed that of 1945. As a nation we produced and consumed more goods and services than in any previous year of peace; nevertheless, consumers had to go without many things they wanted because goods were in greater demand than our capacity to produce.

The year began with 53 million in the civilian labor force and 6 million in the armed forces; it ended with the latter reduced to 2 million and the civilian labor force expanded to more than 58 million. Nevertheless, thousands of establishments still had their "help wanted" shingles hanging outside. In almost every line unfilled orders were piled up to the ceiling — demands for housing, household appliances, automobiles, and clothing appeared to be insatiable. Business eagerly employed returning veterans but in many lines of activity jobs went begging. At the end of 1946 more people were employed in manufacturing, mining, construction, trade, and transportation than at the beginning of the year, and unemployment was negligible.

One of the outstanding changes in the labor market was a continuation in the liquidation of jobs in war industries and the expansion of jobs in peacetime industries. In the Philadelphia area, employment decreased in the manufacture of aircraft, ordnance, and shipbuilding, but new jobs opened up in all other lines resulting in a net gain in employment. Although unemployment was one of the least of our worries in 1946, Congress debated whether private enterprise or the Federal Government should assume responsibility for maintaining sufficiently high levels of employment to assure prosperity. The influence of the issue was reflected in the Employment Act of 1946 which recognized the interest of the Government in maintaining conditions favorable to a high level of employment. The real significance and implications of this Act will be fully realized only with the passage of time and the state of the economy over the years.

A year of shortages The persistence of shortages of many though a diminishing number of items throughout the year served to remind us that supply lines in peace, like those in war, are long. From the farmer or the miner to the retailer is a long road, as most of us learned in our efforts to restock pantry shelves and linen closets. Fortified with an abundance of buying power derived from both past savings and current earnings, consumers competed vigorously with each other for everything that appeared in the market; and producers at every stage, from the retailer back to suppliers of raw materials, likewise had to fight for supplies, equipment, and labor.

Throughout the year industrial production as measured by the Federal Reserve Board's seasonally adjusted index expanded from 160 to 182 per cent of the 1935-39 average. This is more indicative of total productive activity than of output of finished goods, because many of the materials and hours of work that went into the productive machine did not emerge in the form of end products for consumption in 1946.

Many customers were perplexed by the persistent scarcity of goods in the face of expanding production. The explanation lies not only in the fact that a substantial part of the output consisted of machines, materials, and supplies for producers, but also in the fact that inventories had to be replenished all along the line. It is estimated that inventories increased by $10 billion throughout the year. Probably as much as one-third of that was price increase, but shelves and stock piles were generously replenished.

Somewhat in excess of $10 billion worth of new construction was put in place in 1946. This was more than double the activity of the preceding year. Despite the very substantial increase, the output of finished structures ready for use fell behind both plans and expectations, owing largely to insufficient materials and labor. In the case of residential construction, for example, the Veterans' Emergency Housing Program early in the year called for initiating construction of 1,200,000 dwellings. Actually only one million were started and not quite half a million were completed. In this district, contract awards of all types amounted to $400 million but, as elsewhere, rising costs discouraged some new ventures and completions were delayed for want of skilled craftsmen, or hardware, or millwork, or nails.

What the consumer really got

After paying their 1946 taxes, individuals had $146 billion left for their own use. Of that amount they saved $19 billion and spent $127 billion. Spending and saving reverted to about the pre-war pattern — people spent more and saved less than during the war years. In addition to the obvious fact that they had more money, people spent more than the year before for two reasons. Goods were more plentiful, and they cost more.

People had to spend more money for food than in 1945. Food stores did almost $25 billion worth of business — one-fifth above the previous year. Price increases, however, accounted for a substantial part of the expansion in dollar volume; in December food prices averaged about 30 per cent above those at mid-year. Dollarwise, the country's farmers produced a record output but physical quantities were below the previous year and less than the 1944 peak. Gross farm income in the three states represented in the Third District was only fractionally above that of 1945. Dairy and poultry farmers, so prominent in this area, were handicapped by the tight feed situation.

Unable to obtain all the durables they wanted, people spent heavily on nondurables such as apparel, food and drink, but throughout the year more and more durables became available. Automobile manufacturers overcame the handicaps of material shortages sufficiently to turn out two million cars. Though consumer needs were by no means satisfied, they bought increasing quantities of radios, refrigerators, washing machines, and related household requirements.

The changing pattern of consumption is revealed by department store sales. Stores in this district sold more goods of practically every kind in 1946 than in 1945, but the greatest increases took place in such lines as household appliances, furniture, and floor coverings. Toward the end of the year consumer buying reflected increasing resistance to rising prices.

Most restraints imposed on our economy during the war were removed in 1946. Differences of opinion over wages were settled democratically, and all resources were turned to the production of goods for civilian markets. Though tremendous energy was exerted, complete fulfillment of all requirements was not attained owing to large accumulation of consumer needs backed up by heavy spending power and by reason of supply difficulties. In the over-all view, despite some shortcomings and failures, the unrestricted play of conflicting opinions and ideas was paying off. Free men working together in a free nation had again proved a powerful combination.

Banking Developments

With the transition from war to peace, the evolution of sound banking policy and program has not been simple. Faced with an excessive accumulation of spending power in the hands of the public and aware of many distortions in the economy, commercial banks have had none too easy a task in developing policies that mitigate rather than contribute to the distortions. In most instances safety of deposits and maintenance of income have proved far less a problem than the correct evaluation of "service to the community" — one of the three objectives usually regarded as basic in commercial bank operations.

Banking in wartime During the war, bankers as well as industrialists adapted their operations to the requirements of the time. Helping to sell bonds for the Treasury, restricting credits where the public welfare would not be served and extending credit where war aims would be furthered — these were part of their operations. The prime mover in these activities was a sense of patriotic responsibility rather than compulsions.

Banks came out of the war with assets and liabilities altered both in volume and nature far beyond any expectations that might have been held when we stood on its threshold. True enough, at the close of the 1930's the volume of United States Government securities in bank portfolios was much larger than it had been in the 1920's — a result of the deficit financing of the depression and post-depression years. But in the six years ended December 1945 member bank holdings of Governments in this district were multiplied five and one-half times. This reflected the failure of taxes and absorption of securities by nonbank investors alone to supply the funds necessary to finance a war in which expenditures for one year alone were about three times as large as total costs of World War I.

Loans to support the purchase or carrying of Treasury securities increased. Accommodation for business purposes in this district, following a rise through 1941, declined by June 1945 to a point substantially lower than in pre-war 1939. Advance Government payments on contracts, progress payments, and accumulation of internal resources enabled many business concerns in war lines to run at top speed without much help from the usual credit sources. Consumer credit also contracted materially.

The changed pattern of bank earning assets is illustrated in the following percentage breakdown:

Member Banks (End of year)	United States			Third Federal Reserve District		
	1939	1945	1946	1939	1945	1946
Loans	41%	21%	28%	41%	16%	24%
U. S. Gov't obligations	42	73	65	33	75	66
Other securities	17	6	7	26	9	10
Total	100%	100%	100%	100%	100%	100%

In the discharge of its wartime responsibilities, the Federal Reserve Bank of Philadelphia in participation with other Reserve banks also purchased very large amounts of Government securities after 1941. The Reserve banks stood squarely behind the Government's financial program, enabling banks to meet a greatly expanded demand for currency and to obtain the reserves needed to carry growing deposit structures. Largely on the basis of increased holdings of Governments by the banking system, member bank deposits in this district increased from $3¼ billion in 1939 to $6¾ billion in 1945 and the Federal Reserve notes of this Bank expanded from $349 million to $1,635 million.

Banking policy in peacetime In the last half of 1945 there was an overlapping of war finance and the financing of peacetime activities. The last great war loan drive was held in December of that year, but in this district loans to finance civilian industry were already pointing upward. Consumer credit, which had fallen sharply from the peak in 1941, was gaining momentum. Other loans also were reviving.

The decisions facing bankers at this point were crucial. Were they to stay in the riskless market and depend upon their greatly expanded holdings of Government securities to assure safety of deposits and provide earnings? Or were they to revert to their earlier function and give credit service to their communities and assume the risks always to be found in this role? Opportunities for expanding loans were plentiful in most communities. While many businesses had abundant liquid assets, others needed funds for reconversion, building up inventories and to carry receivables. Consumers were ready to borrow to help finance their purchases. And a real estate boom was under way, calling for large amounts of mortgage money.

The record for 1946 indicates that bankers generally chose to enter the loan field, most of them quite actively. Credit to carry Government securities declined with the absorption of these bonds, but the total loans of member banks in the Third District increased by $329 million or 35 per cent. A further increase of $90 million occurred in the first quarter of 1947, indicating no abatement in the demand for loans. By the close of 1946 the proportion of loans to total earning assets had risen to 24 per cent and by March 1947 to 26 per cent, as against 16 per cent in the middle of 1945. It was, of course, still far short of the 40 per cent at the close of 1939 and 69 per cent in 1929, when total earning assets were much lower.

Failure to even approximate ratios in the earlier years cannot be taken as evidence that bankers were not adequately serving their communities. The whole background of banking had shifted in two important respects — the war heritage of huge quantities of Government securities in bank portfolios and a tremendous accumulation of liquid assets in the hands of many business concerns and individuals.

Member Bank Loans (Millions $)	United States			Third Federal Reserve District		
	Dec. 1939	June 1945	Dec. 1946	Dec. 1939	June 1945	Dec. 1946
Business*	6,570	8,221	14,038	363	299	561
Security	1,491	6,496	2,973	87	139	67
Real estate	2,957	3,248	5,358	245	229	344
Consumer	2,944	1,688	3,308	250	172	250
All other		934	1,020		51	40
Total	13,962	20,588	26,696	945	890	1,262

* Including agricultural loans.

Analysis of the loan figures in the foregoing table shows that in the period of approximately one and a half years to the end of 1946 all major types other than those made to carry securities increased considerably.

In the post-war period there also was an accumulation of securities other than issues of the Federal Government. Holdings in this district rose from $437 million in June 1945 to $564 million at the close of 1946, and maintained this level in the first quarter of 1947.

Management of their portfolios of United States Government obligations was an important aspect of policy for banks. But in this instance fiscal policy also played a considerable part. Many short-term securities were retired from bank holdings by the Treasury's redemption program. The decline in Treasury issues was much more marked at the city banks than at the country banks in this district, as the latter group experienced gains in private deposits sufficient to offset the heavy withdrawals from war loan accounts. But whether the decline in short-term Governments was due to redemptions or sales to meet deposit losses, the effect in either case was to lengthen the average maturity of securities remaining in the portfolios. This tendency was furthered slightly by moderate purchases of medium-term issues, but was offset in part by the shortening of maturities with the passage of time. Reports from two-thirds of the commercial banks in this district show the following changes during 1946:

Investment in Governments (Millions $)	Philadelphia banks			Banks outside Philadelphia		
	Dec. 1945	Dec. 1946	Change	Dec. 1945	Dec. 1946	Change
Bills, notes, certificates	783	296	—487	893	605	—288
Bonds callable—						
1946-1950	434	333	—101	484	497	+ 13
1951-1955	696	560	—136	856	868	+ 12
1956-1960	121	144	+ 23	168	220	+ 52
After 1960	61	63	+ 2	242	238	— 4
Nonmarketable issues	6	6	.....	97	95	— 2
Total	2,101	1,402	—699	2,740	2,523	—217
Number of reporting banks	37	35		559	556	

The decline in deposits resulting from the retirement of securities was in inactive war loan balances, part of which were transferred by the redemption process to the potentially more active private deposits. These deposits also were expanded by bank loans and bank purchases of securities other than obligations of the Federal Government. It is the active means of payment that are most important. The record of 1946 and early 1947 shows commodity prices up sharply after the removal of controls, inventories up considerably, distortions in the economy, and other factors that warrant careful examination of the reasons back of the credit growth and that which may lie ahead.

Earnings and profits Developments during the war years resulted in larger profits for banks. Yields on securities and on loans declined materially between 1939 and 1945, but this trend was more than countered by the expansion in Government security holdings, which for member banks in this district became the largest single source of earnings.

A substantial rise in total earnings was more than sufficient to meet growing expenses and income taxes. Noncurrent receipts from recoveries and profits on sales of securities also ran considerably ahead of amounts charged off in 1945 and stayed ahead in 1946. The result was a record level of profits in 1945 — nearly $55 million as against $21 million in 1939. In 1946 current earnings and expenses expanded further and two-thirds of the banks reported larger net profits than in 1945, but the aggregate of such profits declined to approximately $52½ million.

Banks have paid out only about a third of their profits in the last two years. The resulting additions to the capital structure will be helpful in facing the risks to be assumed in credit granting over the years to come.

Sharing the responsibility The exercise of freedom of choice in personal and business activities within rather broad limits — one of the keystones of a democracy — implies a willingness to recognize and assume correlative responsibilities. This is particularly so in the case of bankers, whose actions may affect the volume of money and the stability of monetary values. All of the broad powers lodged in the hands of fiscal, credit and supervisory agencies, and such additional powers as they may be given cannot displace the need for sound judgment on the part of individual bankers. At a time such as this, when the volume of spending power already in existence is so large, everyone who extends credit has exceptional responsibilities.

It is actions of individuals — in banking, in industry, and in trade — that will determine the extent to which we achieve the full benefits of democracy. Errors will be made, but by the interplay of many minds the processes of business and finance can give rise to a maximum of spiritual and material well-being.

The Federal Reserve

The central banking organization, composed of the Board of Governors of the Federal Reserve System and the Federal Reserve Banks, has been directed to exercise its broad powers of credit control in the public interest. Its general objective is to contribute as much as possible to the smooth and sustained functioning of the economy at a high level of activity.

Constant change in the economic picture requires that policies be flexible — tailored to fit changing situations. During the war the primary objective could be none other than to facilitate the financing program of the Government. At the outset the Board of Governors announced that "The System is prepared to use its powers to assure that an ample supply of funds is available at all times for financing the war effort and to exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of the Government's requirements . . ."

This policy, born of necessity, was faithfully carried out. In the process, outstanding Federal Reserve credit increased tenfold from $2.3 billion in early December 1941 to approximately $25 billion at the close of 1945. This expansion was a reflex of the demand for huge quantities of currency and the increasing need for larger bank reserves as deposit structures grew.

The inflationary aspects of deposit and currency expansion were obvious. Spending power, accumulated and currently being made available through income payments, was out of line with the supply of goods and might be expected to continue so for a long time to come. Potentialities in part became actualities as controls were eliminated and the unbalance of supply and demand was free to exert its pervasive influence on the price structure. These changed conditions were recognized in certain actions taken by this Bank and other Reserve Banks during 1946. The preferential discount rate on advances to member banks secured by short-term Governments, established in 1942, was eliminated in the spring of 1946. And buying rates on bankers' bills up to four months in term were advanced somewhat.

A certain amount of pressure was exerted on bank reserves by the Treasury's debt redemption policy, at least to the extent that it involved payment to the Reserve Banks of funds drawn from commercial banks or that it increased required reserves by shifting funds from reserve-free war loan accounts to private deposits as nonbank security holdings were retired. The expansion in private deposits, however, was adding to private purchasing power and bank extension of private credit was having a like effect. For all member banks in this district the figures show gross deposits down one-half billion dollars in 1946, but that part of deposits representing the balances of individuals and business concerns increased by about the same amount.

Federal Reserve credit

Most of the credit extended by this Bank is reflected in its participation in Government securities held in the System Open Market Account. In this way the Bank shares in any steps taken on a national basis to adjust the volume of bank reserves and their availability to the money market. An area remains, however, in which the Bank deals directly with the district's need for Federal Reserve credit.

Dollarwise the volume of direct borrowing from the Bank continues to be relatively minor. Nevertheless, of the approximately 650 members in the district, as many as forty were borrowing here at one time in December and for the year as a whole the number of members receiving such accommodation came to 113.

A somewhat smaller number of banks — 87 — availed themselves of this Bank's facilities for adjusting reserve positions through the purchase or sale of Treasury bills. The dollar volume of bill operations, however, exceeded that of discounts. Bills held by this Bank under repurchase option ranged from $101 million to $254 million, and weekly purchases and sales were as high as $100 million. Diminishing holdings by the commercial banks are narrowing the opportunity for adjusting reserves through this medium.

General operations Outside of the field of credit the Reserve Banks have the responsibility of contributing to the smooth flow of business payments through check collection, currency supply, and other functions, and of facilitating Treasury operations in their roles as fiscal agents. Such operations, which the public has come to take as a matter of course, require the great bulk of the time of the staff.

The aggregate of issues, redemptions, and exchanges of Treasury securities naturally dropped considerably in 1946, following years of intensive activity revolving around great war loan drives and heavy emphasis on inter-drive sales of securities. This permitted a substantial reduction in the full-time staff of the Fiscal Agency Department, elimination of part-time workers, and finally, early in 1947, the return of the Savings Bond Division of the Department from temporary facilities to the Bank's regular quarters.

The volume of Government checks handled also contracted sharply with the reduction in war expenditures, but in other directions operations of the Bank increased substantially. In number of pieces or transactions handled the increases over 1945 were as follows: currency received and counted, 17 per cent; coins received and counted, 14 per cent; ordinary checks handled, 24 per cent. Somewhat smaller increases also were shown in noncash collections and in transfers of funds. Securities held in custody for member banks rose from $2.2 billion to about $2.5 billion.

In addition to the operations of more or less routine character, the Bank administers regulations of the Board of Governors, examines state bank members, and maintains a Department of Research for its own needs and as a service to the banking and business public. Activities along research lines stepped up with the coming of peace and reassertion of the normal forces bearing upon banking and business. Statistical and analytical material is made generally available through regular reports such as the *Business Review,* special releases, and contributions to the data required for meetings and investigations in banking and the business field.

The administration of consumer credit controls under Regulation W continues to require the maintenance of an adequate staff to keep contact with the many concerns granting such credit. Approximately 12,000 are registered in this district. Our experience indicates that compliance with the terms of the regulation in general has been very good.

Directors and officers The terms of John B. Henning as a Class A director of this Bank and James T. Buckley as a Class B director terminated at the end of 1946. In the regular election Mr. Henning was re-elected by the banks of Group 3. Mr. Buckley was unable to accept renomination. To succeed him the banks of Group 1 selected William J. Meinel, President and General Manager of Heintz Manufacturing Company of Philadelphia. Warren F. Whittier, whose term as a Class C director also expired on December 31, was reappointed for three years by the Board of Governors. The Board of Governors appointed Thomas B. McCabe as Chairman of the Board and Federal Reserve Agent and Mr. Whittier as Deputy Chairman in 1946 and redesignated them for service in these capacities during 1947.

David E. Williams, President of the Corn Exchange National Bank and Trust Company of Philadelphia, represented this district on the Federal Advisory Council during 1946 and was reappointed by the Board of Directors of this Bank to serve during 1947.

Effective January 1, 1947, Robert N. Hilkert, formerly Assistant Vice President in charge of personnel, was appointed a Vice President. At the same time Richard G. Wilgus, Manager of the Division of Reports and Analysis of the Bank Examination Department, was appointed an Assistant Cashier. Early in 1946 Robert R. Williams and James V. Vergari, Assistant Vice Presidents, were also appointed Assistant Secretaries of the Bank.

Directors

as of January 1, 1947

Class A:	Group	Term Expires December 31
Howard A. Loeb Chairman, Tradesmens 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	1949
Class B:		
William J. Meinel President and General Manager, Heintz Manufacturing Company, Philadelphia, Pennsylvania.	1	1949
Charles A. Higgins Chairman and President, Hercules Powder Company, Wilmington, Delaware.	2	1947
Albert G. Frost President, The Esterbrook Pen 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 Agricultural Consultant, Chester Springs, Pennsylvania.		1949
C. Canby Balderston Dean, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia, Pennsylvania.		1947

Officers

as of January 1, 1947

ALFRED H. WILLIAMS, *President*

W. J. DAVIS,
First Vice President

C. A. MCILHENNY,
Vice President

ERNEST C. HILL,
Vice President

C. A. SIENKIEWICZ,
Vice President

WILLIAM G. MCCREEDY,
Vice President and Secretary

ROBERT N. HILKERT,
Vice President

PHILIP M. POORMAN,
Cashier

L. E. DONALDSON,
Assistant Vice President

ROBERT R. WILLIAMS,
Assistant Vice President and Assistant Secretary

JAMES V. VERGARI,
Assistant Vice President and Assistant Secretary

KARL R. BOPP,
Director of Research

WALLACE M. CATANACH,
Assistant Cashier

RICHARD G. WILGUS,
Assistant Cashier

NORMAN G. DASH, *General Auditor*

APPENDIX

Statistical Tables

Statement of Condition

Federal Reserve Bank of Philadelphia (000's omitted in dollar figures)	December 31 1944	1945	1946
RESOURCES			
Gold certificates	$ 945,229	$ 878,051	$ 858,145
Redemption fund—Fed. Res. notes	42,799	61,134	61,009
Total gold certificate reserves	$ 988,028	$ 939,185	$ 919,154
Other cash	17,815	15,576	19,235
Discounts and advances	505	4,386	15,547
Industrial loans	2,570	1,763	523
United States Government securities	1,252,245	1,610,468	1,645,130
Total loans and securities	$1,255,320	$1,616,617	$1,661,200
Due from foreign banks	12	10	8
Fed. Res. notes of other F. R. Banks	4,042	7,298	8,181
Uncollected items	153,977	139,850	157,813
Bank premises	3,457	3,313	3,170
All other resources	3,278	4,353	2,912
Total resources	$2,425,930	$2,726,202	$2,771,673
LIABILITIES			
Federal Reserve notes	$1,427,510	$1,635,242	$1,699,277
Deposits:			
Member bank reserve account	710,778	799,634	818,125
U. S. Treasurer—general account	28,722	59,678	34,511
Foreign	106,353	72,195	39,555
Other deposits	4,578	4,308	2,424
Total deposits	$ 850,431	$ 935,815	$ 894,615
Deferred availability items	105,809	106,130	122,081
Other liabilities	613	500	528
Total liabilities	$2,384,363	$2,677,687	$2,716,501
CAPITAL ACCOUNTS			
Capital paid in	$ 12,227	$ 13,064	$ 13,926
Surplus—Section 7	19,872	28,946	34,720
Surplus—Section 13b	4,468	4,501	4,489
Reserves for contingencies	5,000	2,004	2,037
Total liabilities and capital accounts	$2,425,930	$2,726,202	$2,771,673
Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities combined	43.4%	36.5%	35.4%
Commitments to make industrial advances	$3,048	$703	$1,281

Profit and loss account Federal Reserve Bank of Philadelphia (000's omitted)	1944	1945	1946
Earnings from:			
United States Government securities...	$7,275	$ 9,929	$10,600
Other sources	165	134	192
Total earnings	$7,440	$10,063	$10,792
Expenses:			
Operating expenses*	$2,827	$ 3,007	$ 3,704
Cost of Federal Reserve currency......	524	349	373
Assessment for expenses of Board of Governors	211	204	187
Total net expenses	$3,563	$ 3,560	$ 4,264
Current net earnings.....................	$3,877	$6,503	$ 6,528
Additions to current net earnings:			
Profit on sales of U. S. Government securities	$ 263	$ 256	$ 138
Transfers of reserves in excess of requirements	86	150	55
Other additions	41	52	34
	$ 390	$ 458	$ 227
Deductions from current net earnings....	4	5	178
Net additions to current earnings........	$ 386	$ 453	$ 48
Net earnings available for distribution...	$4,263	$ 6,956	$ 6,577
Distribution of net earnings:			
Paid to Treasury of U. S., Sec. 13b....	$ 84	$ 84	0
Dividends paid to member banks.......	719	766	814
Transferred to surplus (Sec. 13b)......	47	32	—11**
Transferred to surplus (Sec. 7)........	3,413†	6,074††	5,774

* After deducting reimbursements received for certain fiscal agency and other expenses.
** Transferred from surplus (Sec. 13b).
† $1,400,000 subsequently transferred from Surplus to Reserves for Contingencies.
†† $3,000,000 also transferred to Surplus from Reserves for Contingencies.

Volume of operations Federal Reserve Bank of Philadelphia	1944	1945	1946
Pieces or transactions handled (000's omitted)			
Discounts and advances	1	1	1
Currency counted	209,594	208,611	243,613
Coins counted	437,431	474,170	540,658
Ordinary checks	112,036	115,501	143,234
Checks handled in packages by automobile run service	16,320	17,321	20,820
U. S. Government checks (including Treasury card checks first handled in 1943)	52,426	70,155	34,410
Ration checks	5,275	5,041	832
Collection items:			
Coupons of U. S. Government and agencies	1,299	1,373	1,400
All other (notes, drafts and coupons)	185	180	193
Transfers of funds	63	65	69
Issues, redemptions, and exchanges by Fiscal Agency Department:			
U. S. Government direct obligations	25,479*	26,756*	17,241*
All other	36	22	16
Dollar amounts (000,000's omitted)			
Discounts and advances	$ 509	$ 1,184	$ 1,065
Currency counted	1,077	1,178	1,428
Coins counted	41	44	48
Ordinary checks	45,548	47,441	56,278
U. S. Government checks (including Treasury card checks first handled in 1943)	8,188	8,401	5,074
Collection items:			
Coupons of U. S. Government and agencies	103	131	152
All other (notes, drafts, and coupons)	243	260	257
Transfers of funds	8,424	9,032	10,323
Issues, redemptions, and exchanges by Fiscal Agency Department:			
U. S. Government direct obligations	9,788*	8,686*	6,902*
All other	110	110	48
Securities held in custody for member banks at end of year	$1,921 mil.	$2,207 mil.	$2,485 mil.
Savings bonds in safekeeping at end of year (number of pieces)	229,000	303,000	345,000

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

Changes in member bank reserves and related items Third Federal Reserve District (Millions of dollars)	1944	1945	1946
Sources of funds:			
Reserve Bank credit extended in district	— 31	+ 39	— 74
Interdistrict commercial transfers	+1,053	+944	+722
Mint gold purchases, net	— 0	— 1	+ 1
Treasury operations	— 676	—660	—587
Total	+ 346	+323	+ 62
Uses of funds:			
Currency demand	+ 281	+233	+ 43
Member bank reserve deposits	+ 65	+ 89	+ 18
"Other deposits" at Reserve Bank	— 1	— 0	— 2
Other Federal Reserve accounts	+ 0	+ 1	+ 3
Total	+ 346	+323	+ 62

All member banks Third Federal Reserve District (Millions of dollars)	Dec. 31, 1946	Change from		Percent distribution	
		Dec. 31, 1945	June 30, 1939	Dec. 31, 1946	June 30, 1939
Assets					
Loans and discounts	$1,263	+$329	+$ 343	18.3%	26.3%
U. S. Government obligations	3,505	— 852	+ 2,756	50.8	21.4
Other securities	564	+ 57	— 63	8.2	17.9
Cash assets	1,471	+ 15	+ 471	21.3	28.6
Fixed assets	65	— 5	— 113	.9	5.1
Other assets	29	+ 2	+ 4	.4	.7
Total	$6,897	—$454	+$3,398	100.0%	100.0%
Liabilities and capital accounts					
Deposits:					
Individuals, partnerships, and corporations—					
Demand	$3,670	+$291	+$2,416	53.2%	35.8%
Time	1,740	+ 198	+ 676	25.2	30.4
U. S. Government	161	— 974	+ 75	2.3	2.5
Bank	394	— 44	+ 11	5.7	10.9
Other	301	+ 32	+ 102	4.4	5.7
Total deposits	$6,267	—$496	+$3,281	90.9%	85.3%
Other liabilities	42	+ 10	+ 21	.6	.6
Capital accounts	588	+ 32	+ 96	8.5	14.1
Total	$6,897	—$454	+$3,398	100.0%	100.0%

Applications for industrial loans Federal Reserve Bank of Philadelphia	1946	June 30, 1934-December 31, 1946
Number		
Approved	6	371
Rejected	0	457
Withdrawn	1	71
Under consideration	0	0
Total number	7	899
Amount		
Approved	$2,530,000	$64,326,426
Rejected	0	17,126,350
Withdrawn	20,000	4,032,700
Under consideration	0	0
Total amount	$2,550,000	$85,485,476

Member bank reserves Third Federal Reserve District (Dollar figures in millions)	Actually held	Required	Excess	Ratio of excess to required
Philadelphia banks:				
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
1947: Jan. 1-15	425	415	10	3
Country banks:				
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
1947: Jan. 1-15	388	339	49	15
All members:				
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
1947: Jan. 1-15	814	754	60	8