RECESSION IN PERSPECTIVE

Annual Report

of the Federal Reserve Bank

of Philadelphia—1954

THE 1953-1954 RECESSION

IN ACTION

AND IN PERSPECTIVE

THE FEDERAL RESERVE BANK
OF PHILADELPHIA

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Recent developments suggest that we take a look at how attitudes toward the problem of controlling business fluctuations are influenced by our economic environment. Such a survey will be useful if it causes us to be on guard against both the over-confidence sometimes inspired by extended booms and the excessive pessimism engendered by prolonged depressions.

This Annual Report deals mainly with business and financial conditions in 1954. The leading developments were the converging of recessionary forces on the durable goods sector, actions taken to counteract the decline, and the emergence of recovery. It also deals briefly with bank examination.

Alfred H. Williams,
President.

CONTENTS

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RECESSION IN PERSPECTIVE

The mildness of the two most recent recessions—in 1949 and 1953-1954—and the widespread belief that a bust can now be prevented, prompt one to attempt putting the problem of business fluctuations in perspective.

Real income per person in the United States has increased fourfold in the past eighty years, according to a study of the National Bureau of Economic Research. This is a remarkable record of growth, and it would probably have been greater had it not been interrupted periodically by business depressions. Growth has been obscured by wave-like movements in business activity, with total output increasing an average of 6.5 per cent annually in periods of expansion, but declining 4.5 per cent annually in periods of contraction. We have been more successful in increasing output per unit of resources used than in keeping these resources fully employed.

"Boom and Bust" on way out?

Why the growing confidence that boom and bust may be on the way out—that our economy has become more stable? One development often cited is the automatic stabilizers built into the Government's fiscal operations. These include such payments as unemployment benefits and agricultural price supports which tend to move in contracyclical fashion. The tax system, aided by highly progressive income-tax rates, mops up an increasing share of income as incomes rise, but a declining share as incomes fall. These built-in stabilizers tend to damp down the flow of spendable funds during a boom and enlarge it during recession. The high level of Government expenditures also provides a hard core of demand which helps to sustain a high level of business activity.

A second structural development has resulted in a more stable money supply. When commercial bank assets consisted largely of short-term loans and commercial paper the volume of deposits was geared closely to changes in business activity. A decline in business activity was usually accompanied by a sharp reduction in the demand for credit, and deposits dwindled as short-term loans fell due and were repaid. There was less check-book money to spend, which tended to bring a further decline in business activity. Bank loan and investment policies, however, have changed materially in the past two decades. Bank assets now consist more largely of Government securities and longer-term loans. These assets are less sensitive to short-run changes in the volume of business activity; in fact, bank holdings of Government securities instead of moving with changes in output tend to rise during recessions and decline during periods of expansion. Thus greater stability in the total volume of bank credit means that changes in the money supply are no longer such a strong force intensifying booms and depressions.

Another change often referred to as contributing to stability is that the debt structure has become less vulnerable to a business decline. Amortization, particularly in long-term mortgage loans, has become standard practice. A good part of mortgage debt outstanding is insured or guaranteed by the FHA and the VA. Regular repayments by the borrower build up his equity. A drop in employment and incomes is less likely to touch off such a large volume of distress selling as in the days of the short-term, unamortized loan.

Growing confidence that the problem of business fluctuations has been pretty well solved also rests, in part, on the belief that we are now better able to deal with the business cycle. We know more about its causes and characteristics. We have more and better statistics for checking the status of our economic health. The present-day forecaster's tool kit bulges with statistics and improved techniques—index numbers, gross national product, time series, correlations, sources and uses of funds, and model building. Consequently, many believe that actions to prevent booms and busts can be better timed.

The problem in perspective

An interesting question is whether this optimism about the business cycle may not stem largely from the buoyant conditions that have generally prevailed since the beginning of World War II. Experience demonstrates that good times breed optimism; bad times, pessimism. There is a close interrelation between economic conditions and views about the business cycle.

Until the early part of this century, booms and depressions were generally regarded as inevitable—the product of natural economic law. Acceptance of this view precluded attempts to smooth out business fluctuations. But the hardship and loss inflicted by recurring financial crises caused some to become impatient with a "do-nothing policy." They rejected the view that such crises were inevitable and that nothing could be done to prevent or mitigate them.

A comprehensive study was initiated in the first decade of the present century to find ways of preventing financial panics and crises—at that time the most obvious aspect of the business cycle. A central bank was suggested as the remedy, and the Federal Reserve System was established in 1914. It soon became apparent though that preventing money panics did not solve the problem of wide swings in production and employment. The World War I boom and post-war depression, which was accompanied by sharp swings in commodity prices, focused attention on stabilizing the price level. Many believed that a stable price level was the key to stable levels of production and employment. Commodity prices were stable and business was good during most of the decade of the twenties; so much so that in the late twenties some espoused the idea that we had entered a new era of permanent prosperity.

The dream of a new era was soon shattered by one of the most severe depressions in our history. Prolonged economic paralysis in the thirties affected our thinking as well as our incomes. It gave birth to another type of new era—that of a "mature economy" which, because of limited private investment opportunities, posed the problem of chronic business stagnation and unemployment. It also brought a marked shift in emphasis from monetary to fiscal policies as to the best method of dealing with depressions.

World War II generated another boom, but there was widespread belief that transition from a war to a peacetime economy would once again pose the problem of depression and large-scale unemployment. The Employment Act of 1946 stated that all governmental activity should be coordinated toward "maximum production, employment, and purchasing power." Full employment became a primary objective of policy both here and abroad. Post-war experience thus far has belied the thesis of stagnation and chronic unemployment. Inflation and boom have been the more serious threats. Ever since the beginning of World War II, except for minor post-war interruptions, our economic machine has been going full blast to meet the tremendous demand for goods and services. The persistent threat of inflation led to the rediscovery of monetary policy both here and abroad. Seeming success of actions to mitigate post-war contractions has led to a rather widespread belief that depressions may be a thing of the past.

One of the lessons of history is to be wary of moods of the moment. Prolonged depressions started us searching for changes which would explain an apparent condition of chronic stagnation; extended booms, on the other hand, have often inspired explanations as to why depressions have become a relic of the past. Realism demands that we avoid being carried away by either extreme.

Achieving stability a complicated problem

Despite some developments contributing to stability there are still many sources of economic instability. Shifts in inventory policy tend to generate short-term changes in business activity. Business expenditures for plant and equipment, although consistently at a high level in the post-war period, usually vary widely over a period of time. Consumers are still fickle. We may go on a borrowing and buying spree, for example, as we did following the outbreak of hostilities in Korea, or suddenly tighten our purse strings. Consumers may eagerly buy certain types of goods today and let them accumulate on the merchants' shelves tomorrow. The money supply, although perhaps more stable than formerly, is still likely to intensify business expansion and contraction unless appropriately regulated. In these days of international tension when total defense outlays are necessarily large, a sharp change in the flow of defense orders may stimulate or depress industries producing military equipment.

Economic progress itself subjects the economy to downward as well as upward pressures. Inventions and new products usually flow from our research laboratories in waves rather than in a constant stream. Invention of the new frequently brings obsolescence of the old. The automobile displaced the buggy, the mechanical refrigerator the ice box, and the vacuum cleaner the broom, and so on. To meet the expanding demand for new products requires more material, capital, and labor. But less is needed to produce the products that are becoming outmoded and obsolete. A progressive economy is dynamic; it is marked by a decline of the old as well as expansion of the new. Maintaining over-all stability and full-capacity operations requires that human and material resources be shifted promptly from declining to expanding industries. Expansion or contraction, whether initiated by cyclical or secular changes, is like a pebble thrown in a pond —the ripples spread in ever-widening circles.

Maintaining both a stable and a growing economy is a complicated problem. It does seem that there has been progress toward achieving this worthy goal. We have more "know-how," more tools, and apparently we are more adept in using them than a few decades ago. Nevertheless, progress will not be facilitated by overlooking the inherent difficulties involved.

For one thing, it is impossible always to time monetary and fiscal and debt-management actions to apply just the right amount of restraint or stimulus at the right time. With present knowledge and techniques, impending business changes cannot be accurately forecast even a few months in advance; and if they could, the public would soon react in such a way that the predicted event would be brought about sooner than was forecast. Yet, time is required to put countermeasures into effect, particularly fiscal policies which require legislative action. And built-in stabilizers, although helpful, cannot be relied on to offset swings in business activity.

Another inherent difficulty is that the immediate problem confronting us is seldom, if ever, all black or all white. Actions that are appropriate for meeting certain conditions may not be appropriate for others. For instance, cyclical and structural changes usually are closely intermingled. It may be difficult at times to determine the extent to which depressed conditions result from cyclical contraction or industrial decay. A cyclical decline calls for actions to expand the flow of purchasing power and total expenditure. Such actions, however, may or may not facilitate the prompt shifting of labor and other resources from decaying to expanding industries. Actions to prop declining industries may delay the shifting of resources and retard economic progress. In our efforts to achieve stability, we must not overlook the effects on progress.

These illustrate some of the barriers on the road to our goal of stable economic growth. This is not to imply that the barriers are believed to be insurmountable. They are difficult to hurdle, however; and success will require even greater efforts to increase our knowledge of the causes and the best methods of dealing with business fluctuations. Excessive optimism, by causing a relaxation of efforts and possibly by inspiring speculative activity, will retard rather than accelerate progress toward the goal.

1954: READJUSTMENT AND RECOVERY

Recession and recovery highlighted the business trend in 1954. The year began in an atmosphere of pessimism. The decline which began in mid-1953 showed no signs of abating and there were some who feared it might snowball into a recession of considerable proportions. Business activity did continue to fall during the first quarter, but it held within a narrow range for the next six months, and then, spurred by a recovery in durable goods production, turned upward. By the end of the year, industrial production had recovered half of the loss from its 1953 high to the 1954 low.

Nineteen fifty-four was a good year. The value of all goods and services produced was only 2 per cent below 1953. The over-all slump in business activity was small, but the impact was uneven. Some industries, principally manufacturers of durables, were hard hit. Mining and transportation also were affected but in most cases to a lesser extent than durable goods. Some industries, on the other hand, hardly felt the impact at all. A few, such as construction, utility and service industries, had a better year than in 1953. Regional differences were pronounced. Heavy durable manufacturing centers suffered most—much more than the over-all decline would indicate. Other localities suffered little, and some not at all.

DEFENSE-INVENTORY READJUSTMENT

The recession resulted mainly from two related developments—a cut in defense expenditures and inventory liquidation. Purchases of goods and services by the Federal Government, which had risen sharply, began to decline in the latter part of 1953. Federal purchases in 1954 were $10 billion below 1953, the drop in national security purchases accounting for $8.4 billion. Business firms, particularly manufacturers, which had accumulated large inventories began to liquidate stocks in the latter part of 1953 and the liquidation continued through most of 1954. The combined fall in defense and inventory spending from mid-1953 to mid-1954 exceeded the drop in total output of goods and services.

Demand slump centers in durables

The slump in the demand for durable goods was spearheaded by a drastic fall in new defense orders. Manufacturers were flooded with new orders as the rearmament program was pushed ahead following the outbreak of hostilities in Korea. The flow of new orders began to subside in the latter part of 1952, but a large backlog of orders cushioned most producers against the effects of the decline until mid-1953. In the second half of 1953, new military orders for hard goods had dwindled to $1.1 billion. Manufacturers of hard goods, heavy durables in particular, bore the brunt of the impact. Producer and consumer demand for durables eased also. Private producers spent 9 per cent less for durable equipment in 1954 than in 1953. The slump reflected completion of much of the tooling up for defense orders as well as some non-defense expansion and modernization programs.

As production and employment began to fall off in the latter part of 1953, consumers became more selective in their buying. Some decided to use the old car or the old refrigerator a while longer and to postpone buying that new TV set or dishwasher. Consumer expenditures for durable goods dropped 8 per cent in the last quarter of 1953, a good part of the decrease being for automobiles. Consumer purchases of hard goods continued at the same level in the first quarter of 1954 and then recovered somewhat. For the year as a whole, consumers spent 2 per cent less for durables than in 1953.

Inventory liquidation

As demand slackened, businessmen became concerned about their inventories. Total stocks which had been built up at a rate of $5 billion annually in the second quarter of 1953 were being liquidated at a rate of $4.2 billion in the fourth quarter. The sagging demand of final purchasers was augmented by a drop in inventory demand.

The flow of defense orders has had an important influence on inventory policy of manufacturers of durable goods. Materials and supplies were accumulated to fill the soaring volume of defense contracts. Manufacturers' inventories rose 35 per cent from the end of 1950 to mid-1953. As order backlogs melted away the sharp cutback in new orders began to affect inventory policy. Manufacturers first reduced their stocks of purchased supplies and materials, then goods in process and finished goods. Total manufacturers' inventories declined $3 billion in 1954, most of the decrease being in durable goods.

Stocks of trading establishments were much more stable than those of manufacturers. There was little change in inventories of wholesalers either in 1953 or 1954. There was a small reduction in retail inventories in 1954, most of it being in durable goods.

Production and employment

The full impact of the dwindling defense and consumer demand for durables hit producers. The cutback in production exceeded the decrease in sales in order that stocks could be reduced. Industrial production dropped 8 per cent in the last half of 1953; it continued to decline but at a slower rate in the early months of 1954, and showed little change until the latter part of the year.

The slump in production, as in demand, centered in durable goods. Output of durables dropped about 12 per cent from mid-1953 to mid-1954, the bulk of the decline coming in the last half of 1953. Primary and fabricated metals, electrical and non-electrical machinery, transportation equipment, and instruments and related products bore the brunt of the recession. Producers of consumer durables were also hard hit. Motor-car production slumped substantially. In mid-1954 about 14 per cent fewer cars were rolling off assembly lines than in mid-1953. Production of major household appliances slumped sharply, output reaching its low at the end of 1953. There was a gradual recovery in 1954 but total output of appliances was considerably below 1953.

The impact on nondurable goods manufacturers was less severe. The softest spots in nondurables were textiles and apparel, and rubber and leather products. Some nondurables such as paper and printing, chemicals and petroleum, and food and tobacco products showed strong resistance to the downward pressure. Output in these industries showed little change from 1953.

The drop in industrial production was accompanied by a decline in employment. Non-farm employment reached its low in August 1954—nearly 2 million below the peak of mid-1953. Most of the decline was in manufacturing, this sector accounting for 90 per cent of the total decrease in non-farm employment. The heavy-goods industries, such as transportation equipment, electrical and other machinery, primary metals, and fabricated metal products, experienced the more severe reductions in employment. Workers were also laid off in other sectors, principally transportation, mining, and the Federal Government.

Unemployment rose substantially between August 1953 and March 1954. Some of the rise in unemployment was seasonal but most of it resulted from the contraction in business activity, particularly in the manufacture of durable goods. The impact of the recession on employment was uneven geographically, as well as among industries. Insured unemployment in 1954 ranged from less than 3 per cent of covered employees in six states to more than 7 per cent or over in nine states. Some communities and regions were hit much harder than the state figures indicate. Unemployment in some centers reflected more deep-seated causes, such as a long-run decline for the products of some industries and the shifting of industries to other regions. The reduced demand for labor was reflected also in a moderate decrease in the average number of hours worked per week.

Wage payments arising from production declined both as a result of fewer people employed and a decrease in the number of hours worked. Profits also decreased, particularly in the depressed durable goods industries.

The extent to which the recession was concentrated in durable goods can be illustrated by a few figures, adjusted for seasonal change. From July 1953 through March 1954, total industrial production dropped 10.2 per cent, durables 14 per cent, and nondurables 5.8; non-farm employment decreased 2.9 per cent, durable manufacturing 9 per cent, and nondurable 4 per cent; and total manhours worked in manufacturing durables fell 14.4 per cent as compared to 7.2 per cent in nondurables.

CONSTRUCTION AND CONSUMER EXPENDITURES RISE

Construction was one of the bright spots in 1954. The surprising strength in this industry was an important force counteracting the impact of the readjustment in durable goods. Total outlays for new construction rose 5 per cent to $37 billion, practically all of the increase being in private construction. Expenditures for the construction of new homes soared to 13 per cent above 1953. Public construction showed little change. State and local governments spent 12 per cent more on construction projects than in 1953, mostly for highways, schools, sewers, and water facilities. The rise was just about offset, however, by an 18 per cent drop in Federal outlays—mainly for defense construction.

New-home starts totaled 1.2 million, compared to the all-time record of 1.4 million in 1950. Why this surprising strength in new-home construction? Such underlying factors as the backlog of demand accumulated during the war, a high rate of new-family formation, and a high level of personal income have kept home building at a high level during much of the post-war period. These factors, however, do not explain the rise in home building in 1954. An important reason was the liberalization of credit terms on Government-guaranteed and insured mortgages, as will be explained later.

The consumer also played a significant part in cushioning the readjustment. Percentage-wise, his role does not look impressive—only a 2 per cent increase in expenditures over 1953. But we should remember that consumers account for two-thirds of total expenditures for goods and services. The small percentage rise in consumer spending was sufficient to offset one-third of the dollar decline in defense and inventory spending.

The consumer did tighten his purse strings a little, especially in the last quarter of 1953. Sales of automobiles declined considerably but began to rise in the early part of 1954. Consumers reduced their purchases of other durables but the decline did not continue for long. Their expenditures for hard goods for the year were only moderately less than in 1953. They spent more for food and about the same for other nondurable items. Service expenditures, such as rent and utilities, continued to rise but at a somewhat slower rate than in 1953.

The moderate rise in total consumer spending in 1954 is not hard to explain. Consumers had more money to spend than in 1953. How explain this seeming paradox of an increase in consumers' spendable funds and a decrease in production and employment? For the answer we must turn to developments along the financial front.

FINANCIAL STABILIZERS

Financial developments played a significant role in cushioning the decline and in checking its spread throughout the economy. These developments reflect the operation of built-in stabilizers, but more significantly positive actions taken by fiscal and monetary authorities.

Fiscal and debt-management policies

The financial operations of the Federal Government have become so large that they have an important influence on the amount of money people have to spend. Every tax dollar paid into the Treasury means someone has a dollar less to spend. Every dollar paid out by the Treasury gives someone another dollar to spend. If the Treasury pays out more than it takes in, the net effect is an increase in spending money; if it takes in more than it pays out there is a decrease.

Consumers spent more and saved as much in 1954 as in 1953, despite the drop in industrial production and employment. Fiscal policy tended to sustain income and spending last year in two important ways.

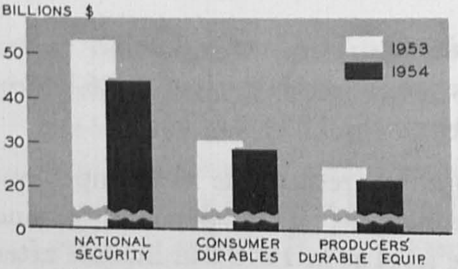
One was the operation of the so-called built-in stabilizers. Unemployment compensation payments automatically increased as employment declined. Total payments to the unemployed were $1 billion more last year than in 1953. Transfer payments of a similar nature added another billion dollars to income. The tax system operated automatically to reduce the tax take. With progressive income tax rates, the loss of income in the depressed industries put some taxpayers into a lower income bracket. As a result, the effective tax rate was lowered and tax receipts fell by a greater percentage than income.

A significant factor bolstering disposable income was the reduction in tax rates. Personal income tax rates were reduced and the corporate excess profits tax was terminated, effective January 1, 1954. Lower excise tax rates on a number of commodities also became effective in April. The Tax Revision Bill of 1954 introduced many changes but had little effect on tax receipts last year. The effect of these tax reductions was offset somewhat by the increase from 1½ to 2 per cent in old-age insurance contributions. The net reduction in tax receipts as a result of these changes was estimated at $6 billion for a full year, but the decrease for 1954 was less.

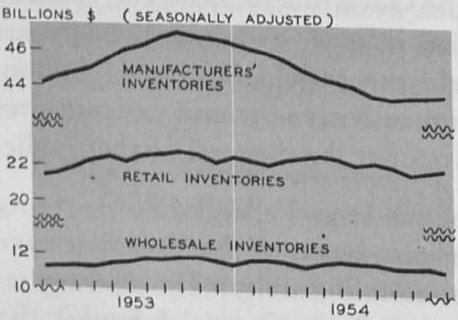
The built-in stabilizers and tax reductions were important forces sustaining spendable income. Total personal income continued at about the same level as in 1953 but income after taxes actually increased $3.5 billion. Despite a slump of over $4 billion in corporate profits, profits after taxes decreased less than one-half billion. The Government, however, reduced its expenditures as well as its tax income. A substantial decrease in actual cash payments held the cash deficit to $1 billion. The over-all effect of Federal cash receipts and expenditures was a small increase in funds put at the disposal of the public.

With a substantial part of the large Federal debt maturing each year, debt-management operations of the Treasury have a significant influence on economic activity. By offering securities which are attractive to the commercial banks, the Treasury can encourage an increase in bank holdings which in turn increases the money supply. On the other hand, if the Treasury offers securities that are attractive to non-bank investors, the tendency is to siphon off savings, leaving the money supply unchanged. Despite its long-term objective of lengthening the maturity of the outstanding debt, the Treasury offered only short- and intermediate-term securities last year. The expansion in commercial bank holdings of Government securities last year was mainly responsible for the increase in the money supply. Another advantage of offering only short- and intermediate-term securities was that the Treasury did not compete with borrowers seeking long-term funds. It was to avoid this sort of competition that the Treasury refrained from bringing out long-term issues in 1954. The result was a larger supply of funds available for mortgages and corporate and municipal securities, which

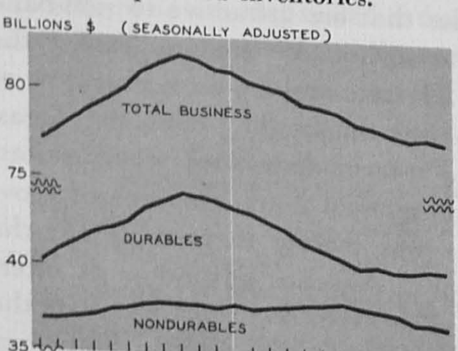
SOURCES OF WEAKNESS



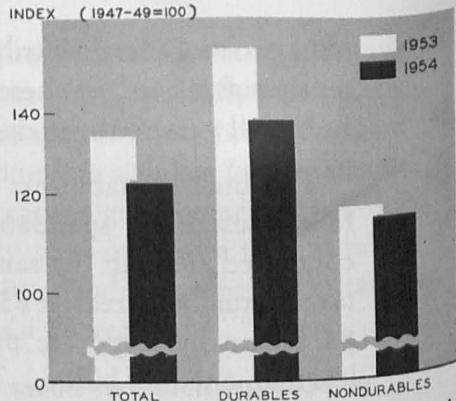
1. National security, consumer durable purchases, and producers equipment declined in 1954.



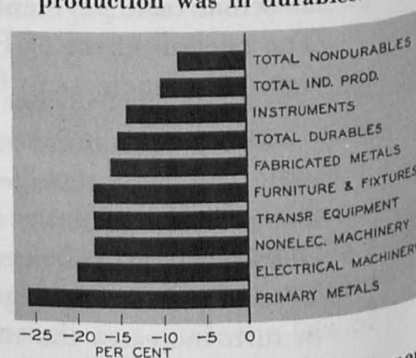
2. The drop in demand of final users was intensified as manufacturers sold more than they produced—they liquidated inventories.



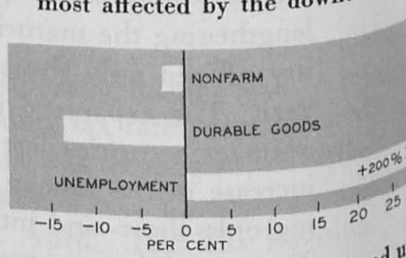
3. Inventory liquidation centered mostly in durables.



4. As a result, most of the decrease in production was in durables.

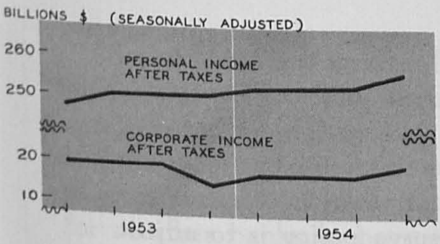


5. Within the durables group, percentage changes from 1953 high to 1954 low show primary metals most affected by the downturn.

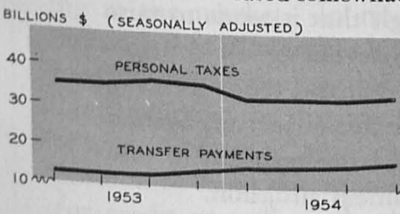


6. And employment declined and unemployment rose—from a low of 1.2 million to 3.7 million.

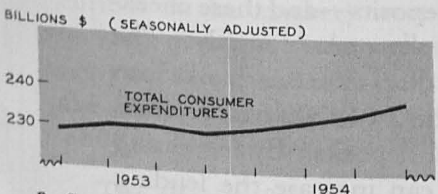
AND STRENGTH 1953-1954



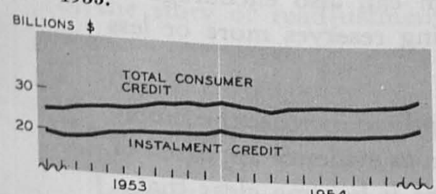
1. In spite of the dip in employment, consumer income held at high levels and even increased somewhat.



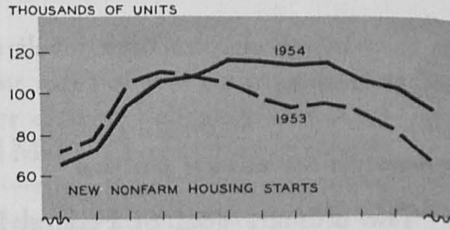
2. The increase came about as the result of an increase in transfer payments and a smaller tax bite.



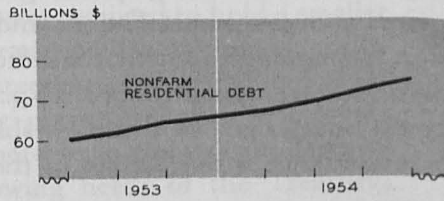
3. So that consumer spending increased by just $4 billion over 1953.



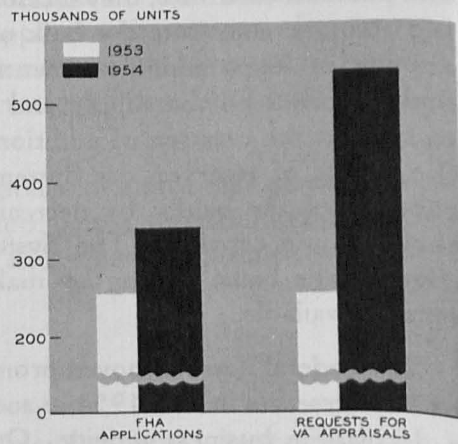
4. But consumers did not increase their instalment borrowing much in 1954.



5. Consumer investment in residential housing was particularly strong the past year.



6. This demand was sustained by a huge volume of mortgage credit.



7. The relaxation of terms on VA and FHA mortgages probably stimulated most of the rise.

helped to sustain the high levels of construction and capital expenditures.

Federal Reserve policy

The ultimate goal of Federal Reserve policy is to adjust the flow of credit in such a way as to promote stable economic growth. In other words, the objective is to prevent credit expansion from lifting spending so high that it tends to raise prices and generate inflation; and to prevent credit contraction from going so far that insufficient demand tends to bring on deflation and depression. To achieve this objective, System credit policy must be flexible—shifting from restraint to ease in accordance with changes in the business situation.

The focal point of Federal Reserve actions is on the reserves of member banks. When commercial banks make loans and purchase securities, they create deposits—and these checking accounts constitute the bulk of our money supply. The amount of loans and investments that member banks can make depends on the supply and the availability of reserves to support the creation of additional deposits. By increasing the supply of reserves, the System can increase the lending capacity of the banks; by decreasing the supply it reduces their lending capacity. The System can also encourage or discourage bank lending by making reserves more or less readily available.

The Federal Reserve moved promptly to increase the supply of bank reserves in mid-1953 as soon as evidence appeared of a decrease in business activity. Once it became clear that a business readjustment was under way, the System adopted a credit policy of "active ease." In general, this policy meant that banks would be supplied with ample reserves to meet all sound credit needs.

Several actions were taken by the System last year in carrying out this policy. The discount rates of the Reserve Banks were reduced from 2 to $1\frac{3}{4}$ per cent in February and from $1\frac{3}{4}$ to $1\frac{1}{2}$ per cent in April and May. These reductions made reserves available at lower rates—they made it less expensive for member banks to borrow reserves to support credit expansion. The reductions also brought the rates charged by the Reserve Banks closer in line with short-term rates prevailing in the market. In mid-year, reserve requirements were reduced; that is, member banks were required to hold a smaller percentage reserve against their demand and time deposits. The reduction in reserve requirements released about $1.6 billion of reserves, thus putting member banks in a better position to meet the seasonal increase in the private demand for credit as well as the borrowing needs of the Treasury, which are larger in the second half of the year. System open-market operations (purchases and sales of Government securities in the market) were coordinated with other actions to keep member banks well supplied with reserves. Free reserves of member banks (excess reserves less borrowings from the Reserve Banks) generally ranged from $500 million to $800 million in 1954.

The effects of the System's policy of active ease permeated the credit market. These developments are an important part of the story of readjustment and recovery during the past year.

Bank credit

Loans and investments of member banks increased $10 billion in 1954, despite the slump in business activity. The bulk of the increase was in investments. Member banks added $5.5 billion of Government securities and $1.5 billion of other securities to their investment portfolios.

Loans increased much less than investments, the total increase being $3 billion. Loans of central reserve city banks to commercial and industrial firms decreased, mainly because inventory liquidation supplied business firms with cash and reduced their need for short-term credit. Business loans of other member banks, especially country banks, increased. Mortgage loans on real estate, loans to purchase and carry securities, and loans to consumers also rose.

How did the increase in bank loans and investments help to stem the decline in spending and business activity? For one thing, it put additional funds at the disposal of borrowers. The ready availabiliy of mortgage money enabled more people to buy and build homes. Banks supplied mortgage funds through direct loans to borrowers. They also supplied funds indirectly through bank purchases of Government securities. Such purchases enabled life insurance companies and mutual savings banks, which sold Governments on balance last year, to obtain additional funds for mortgages and other investments. Non-financial corporations and individuals were also net sellers of Government securities. Thus bank purchases of Government and other securities supplied funds for new construction, corporate outlays for plant and equipment, and state and local expenditures for public improvements.

The increase in bank loans and investments was the principal reason for the $4 billion increase in the money supply (demand deposits plus currency). Checking accounts increased $4 billion, but there was little change in currency in circulation. Time deposits rose more than in 1953, the increase being $5.2 billion.

Money rates

The policy of credit ease was also a significant factor reducing the cost of borrowed funds. As pointed out above, keeping banks supplied with adequate reserves enabled them to expand their loans and investments. The flow of savings into savings institutions was also well maintained. The net result was an increase in the available supply relative to the demand for credit—a condition which brings a decline in interest rates.

Interest rates began to decline in mid-1953. The market rate on Treasury bills—the rate most sensitive to changes in the supply and demand for credit—dropped from 2.2 per cent in June 1953 to considerably less than 1 per cent in June 1954. The rate firmed somewhat after midyear and then leveled off at around 1 per cent. The market rate on high-grade commercial paper—the instrument used by some sales finance companies and large business firms to borrow money—also dropped sharply. The rates on long-term securities—Treasury, municipal, and corporate bonds—declined but not so much as short-term rates. Bank-loan rates to customers are stickier and the regional variation is greater than open-market rates; but there was some easing in rates in the past year, particularly on business loans.

Both the increased availability and lower cost of credit encouraged the use of borrowed funds. The incentive of lower rates is stronger in the case of long-term credit where interest cost usually constitutes a more important part of total costs. Rising securities prices (lower market rates) also encouraged the sale of securities to finance long-term projects. The strong market for municipal and corporate securities was certainly a factor in the rise in state and local public works expenditures and in sustaining a high level of corporate expenditures for plant and equipment.

New securities issues

State and local governments and corporations borrowed large sums last year to finance a variety of long-term projects. The total amount of new securities issued was substantially above 1953. New offerings of state and local governments rose 25 per cent. One of the reasons for the increase was a large volume of revenue bonds issued by state authorities for the construction of turnpikes. Financing was also needed for other highway construction, buildings, and other public improvements. The total volume of new corporate offerings also exceeded the previous year; however, offerings for new money declined. Corporate securities issued to finance plant and equipment expenditures dropped about 5 per cent, but those for raising working capital dropped over one-fourth. As pointed out previously, inventory liquidation was an important factor reducing working capital needs. There was a sharp rise in refunding operations, as corporations took advantage of lower interest rates to sell new securities, the proceeds being used to retire some of their outstanding issues.

Mortgage credit

The ready availability of mortgage credit was a significant factor in the rise in construction expenditures in 1954. Total mortgage debt on non-farm property increased $11 billion. The bulk of the rise was in home mortgages, although mortgage debt on large apartments and commercial properties increased $2.5 billion.

An ample supply of mortgage funds and more liberal lending terms were the significant forces expanding mortgage credit and residential construction. Savings institutions such as life insurance companies, mutual savings banks, and savings and loan associations continued to receive a large inflow of savings. These sources, together with the commercial banks, provided an adequate supply of mortgage money to meet the rising volume of home financing.

A significant factor stimulating home construction was the easing of terms on which credit was made available. Down payments were reduced and borrowers were given a longer period for repayment. Terms for veterans were made especially easy—no down payment and as long as 30 years to pay. This meant that a veteran wanting to buy a home could borrow the full purchase price and, with repayment of principal and interest spread over 30 years, his monthly payments would be relatively small. FHA loans were also made available with smaller down payments and a longer period of repayment.

There is evidence that the more liberal terms for Government-guaranteed and insured loans brought many new buyers into the market. Requests for VA appraisals last year were 110 per cent above 1953. They rose sharply in the first part of the year, remained at an exceptionally high level until the last quarter, and then declined only moderately. Applications for FHA loans were one-third above 1953. Last year, 48 per cent of new-home starts were financed by VA and FHA loans as compared to 37 per cent in 1953.

Consumer credit

Only a small part of the increase in consumer expenditures last year was financed by credit. Consumer credit rose less than a billion dollars, in contrast to an increase of almost $4 billion in 1953. In the first quarter of 1954, consumer credit absorbed income as repayments exceeded new loans. Beginning in April, new instalment loans exceeded repayments for the remainder of the year. The increase in the second and third quarters, however, was less than during the same period of 1953, while expansion in the last quarter was about the same.

One reason for the small increase in consumer credit last year was the slump in demand for durable goods. Instalment credit for the purchase of automobiles, which accounts for about one-third of the total, was little changed in contrast to a 28 per cent increase in 1953. There was a slight decline in instalment credit for the purchase of other consumer durable goods but an increase in personal cash loans. Charge accounts and other forms of non-instalment credit showed little change.

RECOVERY

The readjustment which began in mid-1953 turned out to be milder than many had expected. One reason was that it never spread over the entire economy, for reasons which have already been indicated. Some types of business activity only flattened out; others continued to expand. Production of durable goods bore the brunt of the decline.

Recovery in the depressed industries did not begin all at once; rather it was staggered through most of the year. Production of nondurable goods turned upward at the beginning of the year. There was a slight decline after midyear and then a more pronounced rise beginning in September. Output of major household appliances reached a low at the end of 1953, and then climbed during most of 1954.

The continued decline in defense purchases and inventory liquidation, which centered in the heavy durables, delayed recovery in these industries. Defense purchases decreased throughout 1954, but the rate of decline was much less in the last quarter. The reduction in manufacturers' inventories, which had been going on steadily since the third quarter of 1953, ceased in the fourth quarter of 1954. The cessation of inventory liquidation and slower rate of decline in defense purchases were important factors bringing about an upturn in the heavy durable goods industries. Manufacturers' new orders for durables turned up sharply in the latter part of the year. Production of heavy durables began to climb slowly in August and then more rapidly in the last quarter. Automobile production moved up very sharply in the last two months of the year. By the end of the year, industrial production had regained about one-half of the drop from mid-1953 to the 1954 low.

It seems likely that the sharp rise in automobile output in the last two months of the year exaggerated the extent of the basic recovery. Production was very low in September and October as companies shut down for model change-over. In November, however, output rose sharply. December output was 15 per cent above November. Factories were turning out cars at a rate far in excess of that needed to meet even the most optimistic estimate of sales for 1955. This sharp rise in automobile output was an important stimulus to the production of steel and other materials used by the industry.

Prices were stable

An unusual feature of the 1953-1954 recession was the stability of wholesale and consumer prices. Both indexes showed little change, either in the latter part of 1953 or in 1954.

One reason for the stability in the wholesale and retail price indexes was that final demand for goods and services was well sustained. Government stockpiling supported prices of some strategic materials, and the price support program cushioned the decline in agricultural prices.

THIRD DISTRICT TRENDS

In the past, economic conditions in the Third Federal Reserve District have followed pretty closely national trends. Post-war developments, however, have brought some significant changes in the character of the district's economy. Most important perhaps are the growth of heavy industry in the Philadelphia metropolitan area and the steady decline in the anthracite mining industry. Manufacturing is more important and agriculture less important in the district than in the country as a whole.

Business activity declined

Business activity in the Third District, as in the nation, continued downward in the first part of the year. Inasmuch as the decline centered in manufacturing, the district was affected somewhat more than the country as a whole. A larger part of the total labor force in this district is employed in manufacturing. Also the chronic distress in coal mining—an important district industry—had an adverse effect on employment.

The decline in district employment touched bottom about May. At that time, 12 of the 18 labor-market areas within the district were classified as having a substantial labor surplus. Of these twelve, six including the largest—the Philadelphia labor-market area—had more than 6 per cent but less than 12 per cent of their work force unemployed. The other six areas had unemployment in excess of 12 per cent.

The decline in manufacturing and the rise in unemployment had a depressing effect on other types of business activity. District department-store sales and automobile registrations slumped. Construction, however, was a strong spot in the district as well as nationallly.

Business stabilized during the summer months. In most instances the decline had been arrested and there were some signs of improvement. New claims for unemployment compensation dropped and continued claims began to recede slowly. Department-store sales improved somewhat, and dealers were selling more cars. Contracts for new construction began to rise markedly.

Business activity began to pick up in the fall. As production picked up, more workers were taken back and unemployment declined over most of the district. The anthracite region, however, continued to be an area of "substantial labor surplus." Department stores had a record-smashing Christmas season which brought 1954 sales to the 1953 level. Following the introduction of new models, automobile sales rose sharply. New construction contracts continued to be awarded in unusually heavy volume.

Bank credit expands

Financial developments in the Third District were similar to the national pattern. Credit was easy with an adequate supply available to meet both short- and long-term needs.

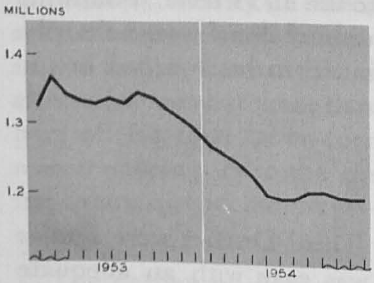
Third District Member Banks

(In millions of dollars)

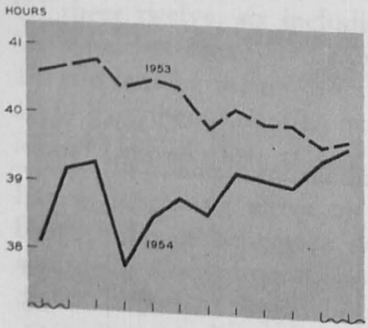
	Amount Dec. 31, 1954	Change in year Amount	Change in year Per cent
Loans			
Commercial and industrial	1,208	+ 5	*
Agricultural	71	+ 8	+ 13
To purchase or carry securities .	136	+ 27	+ 25
Real estate	925	+ 92	+ 11
Other loans to individuals	843	+ 43	+ 5
All other	90	+ 10	+ 13
Total loans—gross	3,273	+ 185	+ 6
Investments			
U. S. Government securities ...	2,812	+ 118	+ 4
State and local government ...	680	+ 155	+ 30
Other securities	248	— 29	— 10
Total investments	3,740	+ 244	+ 7
Total earning assets	6,953	+ 424	+ 6

* Less than 1 per cent.

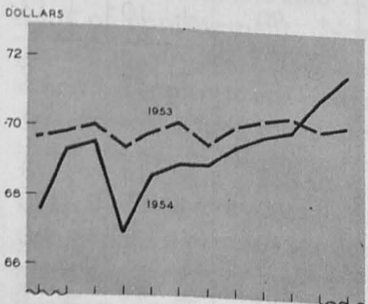
THIRD DISTRICT TRENDS



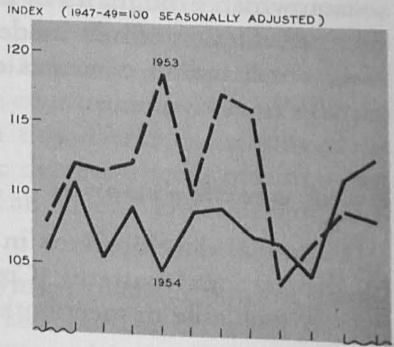
1. Factory employment declines, then levels off.



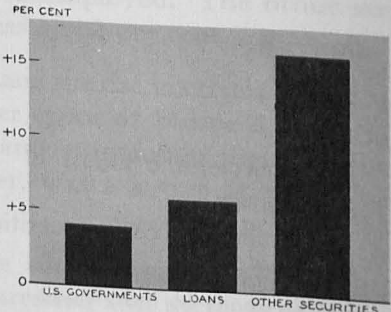
2. And laborers worked fewer hours per week in 1954.



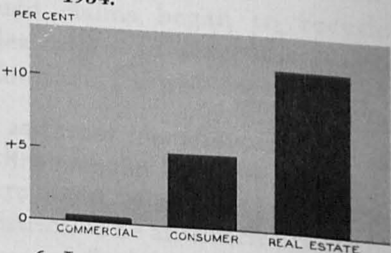
3. As a result, weekly earnings in 1954 were mostly below 1953.



4. And so were department-store sales, but they rose sharply in the latter part of the year.



5. Member bank credit rose in 1954.



6. Loans to business and consumers showed small change for the year, but mortgage credit climbed.

Loans and investments of district member banks rose 6 per cent in 1954, as compared to about 8 per cent for all member banks. The $424 million increase in earning assets of district banks was the largest for any year in the post-war period. Total earning assets reached $7 billion at the close of the year—a record high.

The demand for business loans was not so strong as in 1953. Commercial and industrial loans rose slightly but considerably less than in the previous year. Business loans held up better in the Third District, however, than nationally—the latter showing a small decline for the year. Agricultural loans rose 13 per cent, probably reflecting bank purchases of Commodity Credit Corporation paper. Consumer loans showed some increase. The high level of district building activity generated a strong demand for mortgage credit. Real-estate loans of district member banks rose 11 per cent, approximately the same as nationally.

The bulk of the expansion in bank credit in this district, as nationally, was in the form of investments. A notable feature in the district was the sharp rise in member-bank holdings of state and local government securities. The rise, both in dollar amount and percentage-wise, was greater than for Government securities. District member banks reduced their holdings of corporate securities.

The supply of mortgage credit was ample to meet the strong demand in this district. Insurance companies, savings banks, and savings and loan associations were active in this field as well as the commercial banks. Lending terms were easier, particularly for FHA and VA loans, but mainly in the form of lower down payments and longer maturities. Interest rates on mortgages not insured or guaranteed by the Government did soften somewhat. There was a substantial rise in VA no-down-payment, 30-year loans. But in the latter part of the year, lenders were becoming more insistent on a 5 to 10 per cent down payment, particularly for the 30-year maturity. The secondary market for mortgages was good, but buyers were becoming more selective as the year drew to a close.

IMPLICATIONS FOR THE FUTURE

In looking back on the 1953-1954 recession, what are the implications for the future? One question which naturally arises is why the recession turned out to be so mild.

For one thing, the downward pressures in this latest recession were concentrated—they impinged mainly on heavy durables. Except for soft spots here and there, economic health outside these industries was generally good. More important, perhaps, were the strong forces tending to sustain economic activity. The demand for goods and services by the Federal Government, although declining, was still at a high level. Automatic and positive actions tended to sustain personal and corporate spendable incomes and the credit policy of active ease resulted in an ample supply of credit available on liberal terms. These were strong snubbing forces. The timing of these actions, although motivated somewhat by other reasons, was also good considering the inherent difficulties involved. The Federal Reserve shifted promptly to an easy-money policy once evidence of recession began to emerge. The bulk of the tax reductions became effective January 1, 1954; rather good timing considering that legislative action was required.

Another question is whether cycle downturns have lost their cumulative character. Most theories of the business cycle stress that once a decline starts it tends to spread and deepen. It touches off a chain of reactions which tend to depress other industries and push the depressed industries further down. Recent evidence seems to indicate not that the cumulative type of reaction has been eliminated but rather that under certain conditions snubbing actions may blunt its impact. In 1954, consumer spending rose somewhat more than the increase in personal income after taxes, and commercial banks made use of the bulk of the reserves made available to them. It is significant that the business climate was generally favorable to the use of funds made available—confidence had not been shattered nor had profits disappeared. To what extent the snubbing actions would have been effective had the business climate been far less favorable is a moot question. Experience in the thirties, however, is not reassuring.

The principal lesson to be gained from the 1953-1954 recession is not one of essential changes in the nature of cyclical movements but that coordinated and timely actions can be effective in cushioning a decline as well as in arresting a boom. Monetary, fiscal, and debt-management operations were coordinated toward the common objective of arresting the recession. Monetary and debt-management actions were promptly adjusted to counteract the downward pressures. It would have been better had tax reductions become effective in mid-1953. But tax changes are more difficult to time properly. They require legislative action as well as considerable preparation before changes can be put into effect. The results, however, seem to justify concerted effort to make better use of this arm of fiscal policy in combating booms and depressions than in the past.

EXAMINING BANKS

If we ever lick the business cycle completely, some of the credit should go to the unsung, often unpopular, bank examiner. Fighting the business cycle is not his job, but he does have the task of fostering a sound banking system. And strong banks are an important requisite for economic stability.

Examining banks is only one aspect of the Federal Reserve's broad responsibility for contributing to economic stability and growth. But it is one of the oldest. A basic motive for setting up the Federal Reserve System over four decades ago was to put an end to the recurring money panics which had been plaguing the economy. One of the purposes of the Federal Reserve Act which Congress actually spelled out in the preamble was "to establish a more effective supervision of banking in the United States."

Painful experiences had made it clear that banking was not like other businesses. When banks failed, repercussions were widespread; when banks were strong and healthy, they helped the economy grow. In the area of responsibility delegated to them, the forty-six men and women who work in this Bank's Department of Bank Examination contribute to economic stability and growth by working toward strong banks.

This job is being carried on in the field by an examination force of twenty-six men and at this Bank by an additional twenty people. It has two main aspects: bank examination and bank supervision. No one can say for sure where the dividing line runs, but in general bank examination has to do with getting facts and bank supervision has to do with acting on the facts. Much of the time of the Department of Bank Examination is taken up with analyzing bank reports of condition and earnings and expenses, considering proposed changes in capital structures and corporate functions of banks, considering applications for the exercise of trust powers, implementing examination reports, and other such supervisory activities. In recent years the department has been particularly busy reviewing applications for bank branches and mergers.

A large part of the man-hours of the department, however, is spent in examining the 77 state member banks in the Third Federal Reserve District. At the end of 1954 these banks had commercial department resources of $3½ billion, they held in fiduciary, agency, or custody capacities resources of $3.8 billion and, with their branches, operated 175 banking offices.

The job of examining banks has a number of objectives, depending on how you look at it. We have already described the objective in over-all terms. But while he must keep this in mind, the bank examiner must also think in more specific terms. His day-to-day objective is to get facts—facts which can help him verify and evaluate a bank's assets and liabilities, including management. This is a highly technical, often delicate, in some ways tedious but frequently stimulating job. No one but an examiner knows exactly what it is like. To the extent that words can describe it the following may give some idea.

A "typical" examination

In order to do this we shall try to describe something that doesn't exist—a typical examination. The banks which this Bank examines are as large as $744 million in deposits and as small as $1.3 million. The largest take several weeks to examine; the smallest perhaps only a week. So if we were to look at a typical day in the work of the Department of Bank Examination it would probably involve the examination of a fairly large bank. In fact, some of the toughest problems which the department has confronted in recent years has been in handling the additional work load imposed by the growth of large state member banks through mergers. Today, seven large banks hold three-fourths of the resources of all state member banks in this district.

Yet, over half of all state member banks have deposits of between $2 million and $10 million. Because most banks are relatively small and because the examination process can be traced more clearly, we shall pick a hypothetical bank out of this group for our typical examination.

It is always a state member bank. National banks are examined by examiners working under the Comptroller of the Currency. State banks which are not members of the Federal

Reserve System but are insured by the Federal Deposit Insurance Corporation are examined by the FDIC and the state authorities. State banks which are not members of the Federal Reserve System and are not insured by the FDIC are examined by the state.

Whenever feasible, examiners of this Bank examine state member banks jointly with the state examiners. The FDIC usually accepts reports of these examinations and does not conduct its own. The Chief Examiner of this Bank and the state authorities are in close touch with each other and, between them, decide when to examine certain banks and how much man power each agency should contribute to the examination.

On the chosen day the examiners show up at the bank unannounced. They start the examination either in the morning before the bank opens for business or in the afternoon after the bank has closed. In either case, they face at the outset a major problem of examining the bank without disrupting the bank's operations. It is a little like measuring the pistons of a car without stopping the motor.

The first thing the examiners do is to take control of the bank's assets and certain records. Assets which they can't immediately place and keep under visual control are sealed until later. Then the examiners verify teller cash. In an examination starting in the morning, they must do this quickly so that customers are not kept waiting in the lobby. After verifying teller cash, the examiners check cash in the vault and other cash items.

Speed is also important in checking the deposit account records. While some examiners are still counting cash, others are starting the adding machine listings of checking and savings ledgers. They compare the totals of these listings with the general ledger controls in order to determine whether the deposit ledgers are in balance.

This early phase of an examination can be wearing on the nerves. Much of it is routine. In a bank the size we are talking about, for example, it means counting thousands of individual pieces of currency. In the examination of a large bank the force is largest at this point; before the examination is over the force has shrunk to only a few men. In our typical example, however, the force is much smaller and continues about the same throughout the examination.

Fortunately, this early phase lasts only a day or two and once the cash and ledger listings are out of the way, pressure for speed abates somewhat. The notes in the loan portfolio must also be checked against the several ledger controls, but this does not have to be done quite so quickly.

The examiners now start to get the vault out from under seal. They open the compartments of the vault which hold collateral and the bank's investments, and inspect and compare these items against the records. Other jobs left to do are verifying other deposit liabilities and the shares comprising the bank's capital.

Thus far the examination involves more procedure than judgment. It is in the evaluation of assets that judgment comes into play. In evaluating investments the examiners first look at maturities, then the type of securities (United States Governments, municipals, railroads, public utilities, etc.), and finally quality. They divide the investments into four groups, depending on quality: (1) high-grade bonds, (2) bonds which have speculative characteristics but are not in default, (3) defaulted bonds, (4) stocks.

In making these evaluations, the examiners use their own judgment but are aided considerably by quality ratings published by investment services. Their job is also much easier than it once was because banks now hold a much larger proportion of Government securities in their portfolios. Nevertheless, this phase of the typical examination still requires the examiners to look at several million dollars worth of securities and come up with a considered judgment as to their quality.

A more severe test of the examiners' judgment, however, is in the evaluation of loans. They have no problem with many loans. For the loans secured by life insurance or marketable securities, for example, it is easy to tell simply by the value of collateral whether the loans are covered. But many loans are unique in themselves and require individual analysis. And because examiners rarely can specialize in one or a few industries, they must have a wide background against which to appraise the great variety of loans they encounter. Their background is broadened by the fact that they are constantly going from bank to bank, absorbing the composite opinion of many bankers as to the business outlook and conditions in specific industries.

Examiners are also helped by material in the bank's files. The more complete the credit files the easier the examiners' job becomes and the more accurate their appraisals. In fact, most examiners of long experience believe that loans almost classify themselves as to quality if all pertinent credit data are available. Unfortunately, credit information is not always complete and examiners must form their judgment without all the facts. Some examiners, from experience acquired over many years, have an almost uncanny credit sense and can gauge accurately the quality of loans for which information is scarce.

Examiners classify all loans of inferior quality into three groups: (1) loans involving more than a normal risk, (2) loans on which collection in whole or in part is doubtful, and (3) loans which in whole or in part are uncollectable. These are placed under captions headed "substandard," "doubtful," and "loss."

Everything we have said up to now has to do with the commercial department of the bank. Since 55 of the 77 state member banks in this district exercise trust powers, however, chances are that our typical examination includes the examination of a trust department. Of the twelve examiners in the Department of Bank Examination, seven specialize in examining commercial departments and five specialize in trust examinations. The fourteen assistant examiners do not specialize so much. Over one-third of examination man-hours is spent in examining trust departments. Most of the trust examiners' time, however, is spent in the trust departments of several very large banks. It would take only a few days to examine the trust operations of our typical bank.

During this time, the examiners attempt mainly to determine whether the trust department is being operated properly. A bank, like any other fiduciary, is liable to surcharge if it does not discharge its duties within requirements of law. The examiners bring to management's attention any instances in which the institution's performance could be questioned.

Perhaps the greatest test of the examiners' judgment is in evaluating the bank's management. The first line of defense for a bank's deposits is its capital structure. But management is also very important; good management will be able to avoid most losses. From this point of view alone the examiner has a responsibility to determine the capability of management. Ordinarily, he can get some idea from the quality of the bank's assets. If asset quality is satisfactory, it usually indicates that management is satisfactory.

Good management, however, is also one which builds a vigorous and growing institution that can serve its community. The examiner must judge how well management is providing adequate succession and is meeting the needs of the area.

Altogether, the examiners have spent perhaps the best part of a week getting facts. Now they must make their report. This is a document of about sixty pages, containing tables of figures and the examiners' judgments and recommendations. The examiners first review their findings with management of the examined bank and then submit a draft of the report to the officers in charge of the Department of Bank Examination. After necessary additions and corrections are made, a final draft is prepared. Copies of this report go into the files of this Bank and are sent to the State Banking Department, the Board of Governors in Washington, and the examined bank. This Bank also receives copies of reports of examinations of national banks in this district which are reviewed and analyzed.

At this point, bank examination leaves off and bank supervision takes over. With the copy of the examination report sent to the examined bank is a letter from the officer in charge of bank examination. This summarizes the important findings of the examination and recommends whatever action may be necessary. It requires the charge-off of all items classified in the "loss" category. Of the total "doubtful" classification, one-half is deducted from capital structure in the examiners' report, but usually no actual charge-off is required. If the volume of doubtful assets is significant, however, management may be requested to set up adequate reserves. If the volume of classified assets is large, management is urged to make every effort to improve the quality of assets and, in some cases, to obtain more capital.

Conclusions

How much influence do examiners really exert on the operation of banks? Ask the banker. On the first day of an examination he may feel that examiners were created simply to make his life more complicated than it already is. But by the last day the conscientious banker is welcoming the examiners' objective, unbiased view of his bank. He is anxious to correct any unsatisfactory conditions revealed by examinations. He knows that it is not only good business but is good for the economy for his bank to be strong and healthy.

Of course, bank examiners can't solve all problems. For one thing, they constantly are trying to make the public understand that a bank examination is not an audit. A full audit would involve verifying all liabilities as well as assets, checking all depositors' accounts by getting in touch with depositors, verifying the genuineness of signatures on every note and the accuracy of every figure entered on the books. This is the auditors', not the examiners' job. Yet examiners do try to uncover fraud and, more important, try to encourage measures which will prevent fraud. They review audit and internal control procedures and make suggestions, when necessary, for improving internal safeguards.

Examinations also are not intended to be used as a tool of counter-cyclical policy. By encouraging sound banking policies and procedures, however, bank examiners contribute to a healthy economy. And by drawing on their experience and knowledge of the economy, they can guard against over-confidence in booms and over-pessimism in recessions. They play an important part in the achievement of the objective of the Federal Reserve System—the encouragement of a stable and growing economy.

RESERVE BANK OPERATIONS—1954

The Federal Reserve Bank of Philadelphia made several changes in procedures to improve efficiency. Adaptation of the punch card to the operations of the Bank is constantly being studied. The latest development relates to member-bank reserve accounts. Handled heretofore on accounting and adding machines, this operation is being transferred to punch cards beginning in 1955. This change is expected to reduce costs, supply the banks with more uniform statements of their reserve balances, and facilitate routine checking of the adequacy of reserves carried by individual banks.

Work in the collection department was speeded by a shift in the sorting of checks from an alphabetic to a numeric basis—a change made possible by the fact that over 95 per cent of the checks coming in to us now carry the combined A.B.A. number and routing symbol in the upper right-hand corner. The cash department began to pay out the notes of other Reserve Banks, under an amendment to the Federal Reserve Act permitting this to be done without penalty, with the result that the work of sorting currency was reduced considerably and a substantial saving was effected in shipping costs. Service to member banks was improved by extension of the armored-car service for the delivery of currency and coin to additional communities.

Operations of individual departments of the Bank involve such large amounts as to warrant the description "banking at wholesale." For example, 214 million checks—Government and other—were handled in 1954, an average of over 800,000 each working day. This record volume ran about 3 per cent ahead of 1953. Somewhat smaller quantities of both currency and coin were handled in 1954. But here, too, volume remained very heavy as nearly 300 million pieces of currency and 372 million coins were counted in the course of the year.

Issues and redemptions of Federal Government securities increased further in 1954. In the case of marketable issues, the number of pieces rose from 209,000 to 260,000; for savings bonds, the total of issues and redemptions by this Bank and issuing and paying agents increased from 13,400,000 pieces to 13,900,000. Beginning in August, a major part of the processing of paid savings bonds was transferred to the regional office of the Treasury, but the Reserve Bank continues to receive shipments of bonds from paying agents. This reduction in one phase of the fiscal-agency work was countered in part by a new duty—the processing of postal receipts beginning in January. Postmasters throughout the district send us surplus funds in the form of cash, money orders, savings albums, and checks. We prove each deposit and render an accounting to the Post Office Department.

Borrowing from the Reserve Bank declined considerably, as reflected in a decrease from $31 million in 1953 to $8 million in 1954 in the average daily amount of credit being extended to member banks. The number of banks accommodated also fell off, but not so sharply—from 167 to 138. The lighter use of Federal Reserve discount facilities reflected general easiness in the credit market, due partly to lessened demand in some sectors and also to the System policy of making reserves readily available.

Among the operations summarized in the table on page 49 is the transfer of funds, which increased in number to a new high of 86,000 transactions involving the movement of $43 billion. Expansion also was recorded in the processing of depositary receipts for withheld taxes. Some decline, however, was reported in coupons redeemed, in coupons clipped, and in debit and credit entries incident to direct sendings and the group and wire-clearings plans.

More than 800 bank directors and officers from all parts of the district attended a series of twenty "at-home" meetings held during 1954. They had the opportunity to inspect reserve banking in action and to witness the results of constant efforts to integrate large-scale and diversified operations. In the course of the programs—which included addresses supplemented by flannel-board and other visual aids—the structure and workings of the Federal Reserve System and the credit market were discussed, as well as the instruments of credit policy, developments in the banking field, and the outlook for business conditions.

The objective of contributing to wider understanding of the economy in general and the banking system in particular was served by numerous addresses before other groups, tours of the Bank by educators and students, and such media as the monthly *Business Review*. Valuable data on banking and business conditions constantly are being assembled and analyzed. This is done primarily for the information of those charged with the formulation and administration of banking and credit policy. Disseminated through publications, releases, and by word of mouth, this information also serves the useful purpose of putting into the hands of businessmen and bankers data helpful to them in working out their own problems.

Directors and officers

The terms of Wadsworth Cresse as a Class A director and of Andrew Kaul, III, as a Class B director terminated at the close of 1954. Banks in Group 2 elected W. Elbridge Brown, President and Trust Officer of the Clearfield Trust Company, Clearfield, Pennsylvania, to succeed Mr. Cresse, and Group 3 banks elected Bayard L. England, President of the Atlantic City (New Jersey) Electric Company to succeed Mr. Kaul. Their terms are for three years beginning January 1, 1955.

William J. Meinel was reappointed by the Board of Governors of the Federal Reserve System as a Class C director for a three-year term beginning January 1, 1955. He will continue to serve as Chairman and Federal Reserve Agent during 1955, and Henderson Supplee, Jr., will continue as Deputy Chairman.

The Board of Directors of this Bank appointed William R. K. Mitchell, Chairman of the Board of the Provident Trust Company of Philadelphia as the district's representative on the Federal Advisory Council during 1955. He succeeds Geoffrey S. Smith, President of the Girard Trust Corn Exchange Bank, Philadelphia, Pennsylvania, who served over the years 1952, 1953, and 1954.

James V. Vergari, formerly Counsel and Assistant Secretary, was named Vice President and General Counsel. The Assistant Counsel, Murdoch K. Goodwin, was appointed Assistant General Counsel and Assistant Secretary. Their appointments were effective January 1, 1955.

DIRECTORS as of February 1, 1955

Group		Term expires December 31
	Class A	
1	WILLIAM FULTON KURTZ Chairman of the Board, The Pennsylvania Company for Banking and Trusts, Philadelphia, Pennsylvania	1956
2	W. ELBRIDGE BROWN President and Trust Officer, Clearfield Trust Company, Clearfield, Pennsylvania	1957
3	BERNARD C. WOLFE President, The First National Bank of Towanda, Towanda, Pennsylvania	1955
	Class B	
1	CHARLES E. OAKES President and Director, Pennsylvania Power and Light Company, Allentown, Pennsylvania	1955
2	WARREN C. NEWTON President, O. A. Newton and Son Company, Bridgeville, Delaware	1956
3	BAYARD L. ENGLAND President, Atlantic City Electric Company, Atlantic City, New Jersey	1957
	Class C	
	WILLIAM J. MEINEL, Chairman President and Chairman of the Board, The Heintz Manufacturing Company, Philadelphia, Pennsylvania	1957
	HENDERSON SUPPLEE, JR., Deputy Chairman President, The Atlantic Refining Company, Philadelphia, Pennsylvania	1955
	LESTER V. CHANDLER Professor of Economics, Princeton University, Princeton, New Jersey	1956

OFFICERS as of February 1, 1955

ALFRED H. WILLIAMS
President

W. J. DAVIS
First Vice President

KARL R. BOPP
Vice President

ROBERT N. HILKERT
Vice President

ERNEST C. HILL
Vice President

WILLIAM G. McCREEDY
Vice President and Secretary

PHILIP M. POORMAN
Vice President

JAMES V. VERGARI
Vice President and General Counsel

RICHARD G. WILGUS
Cashier and Assistant Secretary

JOSEPH R. CAMPBELL
Assistant Vice President

WALLACE M. CATANACH
Assistant Vice President

NORMAN G. DASH
Assistant Vice President

GEORGE J. LAVIN
Assistant Vice President

EVAN B. ALDERFER
Industrial Economist

CLAY J. ANDERSON
Financial Economist

MURDOCH K. GOODWIN
Assistant General Counsel and Assistant Secretary

EDWARD A. AFF
Assistant Cashier

HUGH BARRIE
Machine Methods Officer

ZELL G. FENNER
Chief Examiner

RALPH E. HAAS
Assistant Cashier

ROY HETHERINGTON
Assistant Cashier

FRED A. MURRAY
Director of Plant

HENRY J. NELSON
Assistant Cashier

HARRY W. ROEDER
Assistant Cashier

HERMAN B. HAFFNER
General Auditor

APPENDIX - statistical tables

STATEMENT OF CONDITION

Federal Reserve Bank of Philadelphia

(000's omitted in dollar figures)	End of year 1954	1953	1952
ASSETS			
Gold certificate reserves:			
Gold certificates	$1,220,496	$1,300,725	$1,271,008
Redemption fund—Fed. Res. notes	58,928	61,085	57,278
Total gold certificate reserves	$1,279,424	$1,361,810	$1,328,286
Fed. Res. notes of other Fed. Res. Banks	17,291	17,104	16,086
Other cash	16,199	26,837	18,316
Loans and securities:			
Discounts and advances	13,767	4,555	5,476
Industrial loans	612	1,380	3,469
United States Government securities	1,514,656	1,525,491	1,510,542
Total loans and securities	$1,529,035	$1,531,426	$1,519,487
Due from foreign banks	2	2	2
Uncollected items	235,683	253,896	252,296
Bank premises	5,164	4,734	3,269
All other assets	7,915	8,845	9,762
Total assets	$3,090,713	$3,204,654	$3,147,504
LIABILITIES			
Federal Reserve notes	$1,845,959	$1,896,948	$1,857,370
Deposits:			
Member bank reserve accounts	884,622	959,879	929,318
United States Government	39,713	30,135	33,091
Foreign	35,668	30,690	40,833
Other deposits	14,134	8,688	7,093
Total deposits	$974,137	$1,029,392	$1,010,335
Deferred availability items	190,709	201,073	205,923
All other liabilities	685	875	702
Total liabilities	$3,011,490	$3,128,288	$3,074,330
CAPITAL ACCOUNTS			
Capital paid in	$18,982	$18,017	$17,186
Surplus—Section 7	47,773	45,908	43,578
Surplus—Section 13b	4,489	4,489	4,489
Reserves for contingencies	7,979	7,952	7,921
Total liabilities and capital accounts	$3,090,713	$3,204,654	$3,147,504
Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities combined	45.4%	46.5%	46.3%
Commitments to make industrial advances	$128	$1,724	$1,136

EARNINGS AND EXPENSES

Federal Reserve Bank of Philadelphia

(000's omitted)	1954	1953	1952
Earnings from:			
U. S. Government securities	$26,360	$30,649	$27,455
Other sources	260	747	738
Total earnings	$26,620	$31,396	$28,193
Net expenses:			
Operating expenses*	$ 5,923	$ 5,612	$ 5,286
Cost of Federal Reserve currency	634	1,041	817
Assessment for expenses of Board of Governors	311	310	322
Total net expenses	$ 6,868	$ 6,963	$ 6,425
Current net earnings	$19,752	$24,433	$21,768
Additions to current net earnings:			
Profits on sales of U. S. Government securities (net)	30	126	132
All other	—	—	1
Total additions	$ 30	$ 126	$ 133
Deductions from current net earnings:			
Retirement System—adjustments for revised benefits	—	159	—
Reserves for contingencies	27	31	29
All other	—	4	1
Total deductions	$ 27	$ 194	$ 30
Net additions or deductions (—)	$ 3	—$ 68	$ 103
Net earnings before payments to United States Treasury	$19,755	$24,365	$21,871
Paid to United States Treasury (interest on Federal Reserve notes)	16,779	20,974	18,763
Dividends	1,111	1,060	1,023
Transferred to surplus (Section 7)	$ 1,865	$ 2,331	$ 2,085

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

VOLUME OF OPERATIONS

Federal Reserve Bank of Philadelphia

	1954	1953	1952
Number of pieces (000's omitted)			
Collections:			
Ordinary checks	175,300	171,300	169,300
Government checks (paper and card)	38,800	35,400	33,000
Post Office money orders (card)	23,100	23,100	23,600
Non-cash items	900	900	800
Clearing operations in connection with direct sendings and wire and group clearings plans*	1,078	1,191	1,260
Transfers of funds	86	82	73
Currency counted	299,200	319,100	304,200
Coins counted	372,400	439,700	412,800
Discounts and advances to member banks	1	2	1
Depositary receipts for withheld taxes	361	349	336
Fiscal-agency activities:			
Marketable securities delivered or redeemed	260	209	157
Savings bond transactions— (Federal Reserve Bank and agents)			
Issues (including re-issues)	7,042	6,815	6,247
Redemptions	6,889	6,609	6,132
Coupons redeemed (Government and agencies)	894	915	944
Dollar amounts (000,000's omitted)			
Collections:			
Ordinary checks	$51,376	$51,747	$48,264
Government checks (paper and card)	6,313	5,025	4,364
Post Office money orders (card)	339	338	331
Non-cash items	172	159	149
Clearing operations in connection with direct sendings and wide and group clearings plans*	25,512	26,532	22,873
Transfers of funds	43,176	33,963	30,798
Currency counted	1,931	2,084	1,943
Coins counted	47	57	50
Discounts and advances to member banks	759	4,028	5,115
Depositary receipts for withheld taxes	1,289	1,245	1,059
Fiscal-agency activities:			
Marketable securities delivered or redeemed	11,036	8,970	8,405
Savings bond transactions— (Federal Reserve Bank and agents)			
Issues (including re-issues)	495	406	388
Redemptions	477	412	321
Coupons redeemed (Government and agencies)	89	89	87

*Debit and credit items.

MEMBER BANKS

Third Federal Reserve District

Statement of Condition

(Dollar amounts in millions)	Dec. 31, 1954*	Change in year**	
		Amount	Per cent
Assets			
Loans and discounts	$3,213	+$180	+ 6%
U. S. Government securities	2,812	+ 118	+ 4
Other securities	928	+ 126	+16
Cash assets	1,832	— 74	— 4
Fixed assets	95	+ 12	+14
Other assets	30	+ 4	+13
Total assets	$8,910	+$366	+ 4%
Liabilities and Capital Accounts			
Deposits:			
Individuals, partnerships, and corporations—			
Demand	$4,660	+$126	+ 3%
Time	2,169	+ 139	+ 6
U. S. Government	202	— 13	— 6
Other	1,010	+ 71	+ 7
Total deposits	$8,041	+$323	+ 4%
Other liabilities	83	+ 11	+16
Capital accounts	786	+ 32	+ 4
Total liabilities and capital accounts	$8,910	+$366	+ 4%

Earnings, Expenses, and Profits

(Dollar amounts in millions)	1954*	Change in year**	
		Amount	Per cent
Earnings			
On U. S. Government securities	$ 54.4	—$ .2	—
On other securities	19.2	+ 1.4	+ 8%
On loans	151.0	+ 8.0	+ 6
Other earnings	42.6	+ 2.8	+ 7
Total earnings	$267.2	+$12.0	+ 5%
Expenses			
Salaries and wages	$ 81.6	+$ 5.8	+ 8%
Interest on deposits	24.0	+ 2.8	+ 13
Other expenses	60.4	+ 4.0	+ 7
Total current expenses	$166.0	+$12.6	+ 8%
Net current earnings before income taxes	$101.2	—$ .6	— 1%
Recoveries, profits on securities, etc.†	$ 18.8	+$11.0	+141%
Losses, charge-offs††	23.3	— .7	— 3
Taxes on net income	38.1	+ 5.5	+ 17
Net profits	$ 58.6	+$ 5.6	+ 11%
Cash dividends declared	30.9	+ 3.8	+ 14

*Preliminary.
**Adjusted for mergers and changes in membership.
†Includes transfers from valuation reserves.
††Includes transfers to valuation reserves.

FACTORY EMPLOYMENT AND HOURS*
Third Federal Reserve District

	All Manufacturing		Durable Goods		Nondurable Goods	
	Employment	Weekly hours worked	Employment	Weekly hours worked	Employment	Weekly hours worked
1949	1,161.3	38.8	498.4	39.1	662.9	38.6
1950	1,190.2	40.0	512.7	40.9	677.5	39.4
1951	1,259.5	40.3	584.2	41.8	675.3	39.2
1952	1,272.0	40.4	606.9	41.7	665.1	39.4
1953	1,327.5	40.2	660.0	41.2	667.5	39.3
1954	1,214.2	38.9	583.4	39.5	630.8	38.4
1954 January	1,265.5	38.1	623.5	38.9	642.0	37.4
February	1,256.7	39.2	613.9	39.9	642.8	38.7
March	1,244.0	39.3	604.3	39.9	639.7	38.8
April	1,222.9	37.8	594.9	39.1	628.0	36.8
May	1,197.5	38.5	576.8	39.2	620.7	38.0
June	1,191.9	38.8	567.6	39.4	624.3	38.4
July	1,193.3	38.6	572.5	39.0	620.8	38.4
August	1,202.3	39.2	569.2	39.3	633.1	39.1
September	1,204.0	39.1	569.9	39.5	634.1	38.7
October	1,199.4	39.0	571.4	39.8	628.0	38.3
November	1,197.4	39.4	568.3	40.2	629.1	38.8
December	1,196.0	39.6	568.6	40.0	627.4	39.2

*Estimates of employment include production and nonproduction workers. Average hours cover only production workers.

INCOME AND PRICES

Factory Payrolls: 1949=100 Farm income — Prices: 1947-1949=100	Factory Payrolls—Production Workers Third Federal Reserve District			Income from farm marketings N. J., Pa., and Del.*	Consumer prices in Phila.†
	All Manufacturing	Durable goods	Nondurable goods		
1949	100	100	100	96	102
1950	111	112	110	93	102
1951	127	140	116	111	112
1952	131	150	117	110	114
1953	145	174	122	108	115
1954	129	147	115	100	116
1954 January	132	156	114	95	115
February	134	156	118	88	115
March	133	152	118	98	115
April	125	146	109	93	115
May	125	142	112	96	115
June	125	140	114	98	116
July	125	142	113	115	116
August	128	142	118	121	116
September	129	144	118	108	116
October	129	146	116	107	116
November	131	149	117	96	116
December	131	149	119	88	116

Sources: *U. S. Dept. of Agriculture. †U. S. Bureau of Labor Statistics.

DEPARTMENT STORE SALES

1947-49=100 (Adjusted for seasonal variation)	Third District	Phila-delphia	Lan-caster	Reading	Scranton	Trenton	Wilkes-Barre	York
1949	100	99	100	99	100	105	98	100
1950	106	104	108	102	109	116	101	106
1951	109	106	110	104	110	121	100	114
1952	109	104	111	104	114	122	99	117
1953	111	106	115	107	116	121	99	129
1954	108	106	111	104	115	114	94	122
1954 January	106	102	115	103	114	111	91	123
February	111	108	105	96	114	114	95	120
March	106	103	107	105	110	110	85	121
April	109	107	110	103	124	121	94	130
May	105	102	114	101	110	104	89	123
June	109	110	109	104	114	118	91	121
July	109	106	117	107	111	118	91	131
August	107	108	110	101	111	109	93	120
September	107	107	104	107	120	114	98	111
October	105	100	113	105	114	116	89	121
November	111	110	111	108	111	114	98	115
December	113	109	116	107	121	118	104	125

DEPARTMENT STORE INVENTORIES

1947-49=100 (Adjusted for seasonal variation)	Third District	Phila-delphia	Lan-caster	Reading	Scranton	Trenton	Wilkes-Barre	York
1949	99	97	99	100	105	105	100	101
1950	108	107	108	106	114	105	110	112
1951	127	125	124	131	134	127	126	128
1952	113	110	114	114	116	113	109	119
1953	119	114	121	122	121	116	113	132
1954	116	112	125	116	129	103	101	126
1954 January	114	110	125	113	117	98	109	129
February	112	111	124	111	113	94	100	119
March	112	110	122	111	123	102	104	124
April	114	110	125	115	131	113	97	128
May	116	113	125	121	134	103	98	128
June	117	114	126	117	137	101	97	125
July	116	114	128	113	134	101	97	131
August	115	110	126	117	133	98	99	124
September	117	112	125	118	132	107	102	124
October	116	112	123	119	121	103	100	121
November	118	114	125	118	132	107	105	124
December	120	116	132	123	133	114	109	131