FEDERAL RESERVE BANK OF PHILADELPHIA

BUSINESS REVIEW

AUGUST 1959

Guides to Monetary Policy

Appliances in an Expanding Market

GUIDES TO MONETARY POLICY

The meetings of the Federal Open Market Committee have become a forum for the discussion and formulation of monetary policy, as well as open market policy. This Committee, which meets once every three weeks, consists of the seven members of the Board of Governors and five of the presidents of the Reserve Banks. The presidents of the other seven Reserve Banks are also invited and attend the meetings.

An important question confronting the Committee at these meetings is what degree of ease or restraint will best contribute to attainment of the three general objectives of monetary policy. These objectives are: to keep the price level stable, to help maintain business stability at high levels of production and employment, and to foster sustained economic growth. To achieve these objectives, monetary policy must be flexible. When business activity is rising and credit is expanding, restrictive action may be needed to prevent rising prices and the development of an unsustainable boom. When business activity is declining the need is for a policy of easy credit to bolster demand and to help promote recovery.

A great variety of information is needed in making a policy decision as to ease or restraint —current trends and the immediate prospects in production, employment, inventories, spending, prices, credit, the money and capital markets, Government finance, etc. In fact, practically all available business and financial data are relevant in some respect. Among the types of information needed are data which will indicate the current availability of credit—how tight or how easy. Some notion as to existing credit tightness or ease is a prerequisite in making a decision as to whether a change is desirable.

This article deals with bank reserves, the money supply, and market rates of interest. The problem of guides in conducting day-to-day open market operations—of deciding when reserves should be put into or withdrawn from the market—is also considered briefly.

Free reserves

One measure of the availability of credit is the net reserve position of the member banks. Member banks are required by law to hold a certain percentage reserve against their deposits. An expansion in loans and investments increases deposits. More deposits mean a larger amount of reserves will be required. The capacity of a bank to extend credit is determined by its reserve position. If it has excess reserves the bank can make more loans and purchase securities; if not, the bank cannot increase its loans and investments without getting more reserves. The

capacity of the banking system to expand credit depends on the combined reserve positions of the individual member banks.

This net position is called free or borrowed reserves. Sometimes the latter is referred to as negative free reserves. Free reserves are the amount by which total excess reserves of member banks are greater than total member bank borrowings from the Reserve Bank. It means that member banks, as a whole, already have excess reserves to support additional credit expansion. When total borrowings are greater than total excess reserves, the difference is net borrowed reserves. On balance, member banks not only do not have excess reserves to support additional credit expansion, they are using some borrowed reserves.

The net reserve figure is a good indicator of the ease or pressure on the combined reserve positions of member banks. Net free reserves reflect a relatively easy reserve position. The higher the level of free reserves, the greater is the capacity of the banking system to extend credit without the necessity of obtaining additional reserves. On the other hand, net borrowed reserves indicate a relatively tight reserve position on balance. A higher level of net borrowed reserves usually reflects not only a larger net indebtedness to the Reserve Banks, it probably means also that more banks are finding it necessary to borrow.

Another advantage of the net reserve position as a guide is that it reflects the combined effects of Federal Reserve actions and market factors on member bank reserves. Market factors—such as float, Treasury operations, and currency in circulation—are often predominant in daily and even week-to-week changes in reserve positions. The Federal Reserve has no control over these factors; it can only take such action as may seem desirable to offset them. Market factors, it should be noted, are so volatile that weekly changes in reserve position may or may not be as intended.

Even though the net reserve position of all member banks is a good indicator of the ease or pressure being exerted on reserves by System actions and market factors, a given level of net free or net borrowed reserves does not always mean the same degree of ease or restraint. There are other factors that need to be considered.

The net reserve position of member banks combines into one figure banks with markedly different reserve management policies. Many country banks try to maintain a cushion of excess reserves. Larger banks in financial centers strive to keep their funds fully invested. Their policy is not to hold excess reserves. Excess reserves, therefore, are concentrated in country banks. A flow of reserves from banks in financial centers usually results in tightness in the money market. Country banks often hold newly acquired reserves as excess for a time instead of using them immediately to purchase securities or lending them in the federal funds market. On the other hand, a shift of reserves from country banks to the financial centers usually results in easier credit conditions in the money market. Restraint or ease is influenced by the distribution as well as the level of net borrowed or net free reserves.

Bank lending policies are affected by banker attitudes as to the availability of more reserves as well as by the current reserve position. A banker is unlikely to be concerned over a reserve deficiency so long as reserves can be readily obtained on favorable terms. Attitudes toward reserve availability are influenced by such factors as the source of reserves, the state

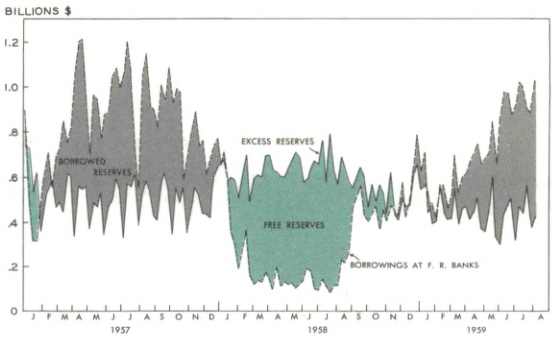
of the securities market, and a bank's asset structure.

The influence of these factors is well illustrated in the two periods March to August 1957 and March to August 1958. The net reserve position was considerably tighter in the former, borrowed reserves averaging $438 million. On balance, member banks were using a margin of reserves that had to be repaid shortly. In the period March to August 1958, net free reserves averaged $491 million. Member banks had a cushion of excess reserves to support credit expansion.

Maintaining a certain level of net borrowed or net free reserves over a period of time means, in effect, that the System is supplying reserves as rapidly as they are used to support deposit expansion and as they are drained away by market factors. It is like maintaining water in a reservoir at a fixed level—the inflow must equal the outflow. Another reason credit was considerably tighter in the March to August 1957 period was that a combination of factors tended to reduce the availability of additional reserves.

In the period March to August 1957, reserves were made available by the Federal Reserve primarily through the discount window. Loans and advances to member banks increased $345 million, and daily average borrowing from the Reserve Banks during the period ranged from about $800 million to slightly over $1 billion. Only $35 million of reserves were supplied by System open market operations. From March to August 1958, when the Federal Reserve was pursuing an easy-money policy, the System supplied reserves at its own initiative. It increased its holdings of Government securities by over $2 billion, and $1½ billion of required reserves were released by reductions in reserve requirements. The quantity of reserves supplied was

MEMBER BANK RESERVES



sufficient to offset substantial reserve drains from an outflow of gold and an increase in currency in circulation and, in addition, to enable member banks to repay most of their indebtedness to the Reserve Banks and provide a substantial cushion of excess reserves. Member bank borrowing was at a very low level, ranging within a daily average of $150–250 million.

A policy of supplying reserves primarily through the discount window diminished significantly the availability of reserves. Many member banks are reluctant to borrow from a Reserve Bank. With a net borrowed reserve position and the Federal Reserve not supplying reserves through open market operations, the sale of securities by some banks to acquire reserves is likely to shift reserve deficiencies to other banks. As reserve pressure continues an increasing number of banks are compelled to borrow from the Reserve Banks. Furthermore, borrowed reserves enlarge a bank's lending capacity only temporarily. They must be repaid. Reserves supplied through open market operations or released by a reduction in reserve requirements do not have to be repaid—they are owned, not borrowed reserves.

The state of the securities market was another reason for the diminished availability of re-

serves in the March–August 1957 period. The sale of securities was a source of reserves for the individual bank but not for the banking system because the Federal Reserve added very little to its holdings of Government securities. Business expansion and a strong demand for credit along with the restrictive credit policy resulted in a rise in interest rates. Banks are reluctant to sell securities at a loss; hence the market became a less attractive source of reserves as the prices of Government and other fixed-income securities declined.

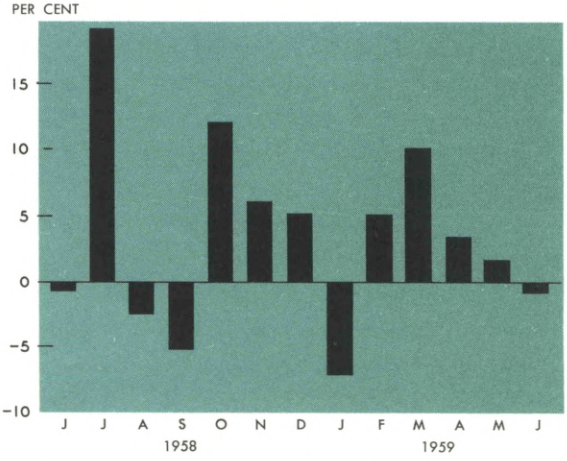
A certain level of net free or borrowed reserves may result in varying degrees of ease or restraint because of changes in the willingness of banks to use reserves. The liquidity position of banks has an important influence on their willingness to extend credit. Most bankers like to maintain certain minimum liquidity standards. Some think in terms of a minimum ratio between liquid assets and deposits; others may put more emphasis on a maximum loan-to-deposit ratio. Although liquidity standards are somewhat flexible, bankers become more careful about expanding loans the closer these standards are approached. A rise in loan-to-deposit ratios and reduced holdings of Government securities and other liquid assets in periods of expansion may cause banks to be more reluctant lenders, even though there is no change in their over-all reserve position. Conversely, declining loan-to-deposit ratios and a rise in liquidity probably result in greater availability of credit even though there is no change in net borrowed or net free reserves. Economic conditions may also influence bank willingness to use reserves. In the thirties, for example, an exceptional desire for liquidity together with little loan demand and limited investment outlets caused bankers to hold large excess reserves.

The effects of reserve availability and willingness to use reserves on bank credit expansion are well illustrated in the two periods. From March to August 1957 the demand for credit was strong, and member bank loans rose $3 billion. But banks liquidated securities to obtain part of the funds needed for loans. Total member bank deposits increased only $2 billion. In the period March to August 1958 the demand for bank credit was somewhat weaker because of the recession. Loans increased only $1 billion, but banks used reserves being supplied by the Federal Reserve to add over $9 billion to their holdings of securities. The increase in total deposits exceeded $9 billion.

Money supply and velocity

Altering reserve positions expands or contracts the capacity of banks to extend credit. But reserve data do not show how banks respond. The real test of actions to alter reserve positions is their net effect on the amount of money that banks put at the disposal of the public. The

MONTHLY CHANGES IN MONEY SUPPLY*
(Annual Rate—Seasonally Adjusted)



* Demand Deposits Adjusted Plus Currency.

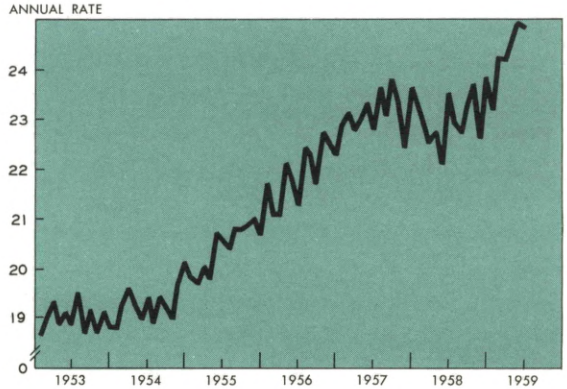
money supply, which consists mainly of demand deposits, reflects the combined effect of changes in bank loans and investments.* It is the best indicator of the extent to which actions to affect reserves have influenced the amount of money available for expenditure.

The money supply is not an unerring guide as to the impact of restrictive or easing actions. Short-run changes are sometimes erratic. Allowing for seasonal factors, monthly changes in currency plus demand deposits adjusted during the past year ranged from expansion at an annual rate of nearly 20 per cent in July 1958 to contraction of 7 per cent in January 1959. The July increase was exceptionally large; however, considerable short-term—even daily—variation in the total volume of demand deposits is not unusual. Float (the amount which has been credited to the account of those depositing checks but not yet deducted from the deposits of those writing the checks) results in daily, intra-monthly, and seasonal changes in deposits. Other factors such as System open market operations, Treasury operations, gold imports and exports, and an inflow or outflow of currency, also cause fluctuations in the volume of deposits. The effect of some of these factors on deposits is frequently temporary and tends to cancel out in a relatively short period of time. Monthly averages of daily figures show somewhat smaller fluctuations than data for the last Wednesday of the month.

Data on the money supply need to be supplemented by information on velocity. Spending is influenced by the rate of turnover as well as by the quantity of money. A $5 bill spent twice during a month supports as much expenditure as a $10 bill spent once. Data on the rate of turnover of demand deposits, seasonally adjusted, for 337 reporting centers other than New York City and six other leading financial centers reveal two types of fluctuations. One is pronounced and somewhat erratic short-term changes. The other is cyclical—an upward trend during periods of rising business activity and a downward trend during periods of declining activity. In periods of expansion, rising interest rates activate idle balances and, in general, money is used more intensively. When business is slack, people spend less freely, and lower market rates offer less inducement to keep cash balances at a minimum. Hence the rate of deposit turnover declines during a recession.

In considering the impact of System actions, one should take into account changes in velocity as well as changes in the money supply. Typically, changes in velocity tend to counteract rather than reinforce System actions. In periods of rising business activity an increase in velocity means that expansion in the quantity of money needs to be restricted more than if velocity were constant. In recession, velocity usually declines so that a larger increase in the money supply is required to provide a given stimulus to total spending.

TURNOVER OF DEMAND DEPOSITS
(Seasonally Adjusted—337 Centers)



* The money supply as used here includes demand deposits adjusted plus currency and coin outside banks. The question of how the money supply should be defined is not considered.

Market rates

Market rates of interest, just as any other price, perform important functions in a free-market economy. They reflect the interplay of the supply of and demand for credit in the money and capital markets. Changes in rates are a significant force in bringing supply and demand into balance. For example, an increase, by making it more expensive to borrow and more attractive to lend or invest, tends to reduce demand and increase supply. The spread between rates also influences the flow of funds into different segments of the market. The effect of rising rates on the supply of funds available for mortgages is a good illustration. The maximum rate on Government-guaranteed mortgages is fixed, and the rate on conventional mortgages typically rises more slowly than market rates. As market rates rise, other investments become more attractive and reduce the supply of funds going into mortgages, especially Government-guaranteed mortgages. Market rates play an important role in allocating the available supply of credit among competing borrowers.

Market rates are useful indicators because they reflect supply-demand relationships in a market that is related to but differs considerably from that served by commercial banks. The money market is an important source of funds for a variety of institutions. Member banks, primarily the larger banks in financial centers, borrow and lend excess reserves. This segment of the market is commonly referred to as the federal funds market. The bulk of these transactions—referred to in the market as purchases and sales of federal funds—are for a maturity of one day. The major borrower in the short-term securities market is the Federal Government. Treasury bills account for a large part of total money-market instruments outstanding. Other borrowers are sales finance companies and a relatively small number of business corporations which sell short-term paper in the market. The principal suppliers of funds in the short-term market are large business corporations, commercial banks, and other financial institutions.

The money market is also a source of funds for holders of short-term paper and securities. Holders in need of funds may sell short-term securities to those with temporary surpluses to invest. The money market is a medium for shifting funds from institutions with temporary excesses to those with temporary deficiencies.

The principal borrowers in the capital market are corporations, state and local governments, and at times the Federal Government. State and local governments issue bonds to finance roads, schools, and other public improvements. Corporations issue securities, principally bonds, to help finance plant and equipment expenditures. Savings institutions, such as savings banks, insurance companies, and pension and retirement funds, are important purchasers of these longer-term securities and hence suppliers of long-term credit.

Credit instruments traded in the money and capital markets differ in many respects—maturity, credit rating, etc. As a result there is a complex structure of market rates. A common classification is based on maturity—short-term, intermediate, and long-term rates. The level of market rates rises in a period of business expansion and credit stringency. The supply of funds in all segments of the market becomes less plentiful relative to demand. The reverse is true in a period of recession, and rates decline. Changes in supply-demand relationships are not uniform throughout the rate structure. Typically, short- and intermediate-term rates are more vol-

atile—increasing more sharply in a period of rising market rates and declining more in a period of falling rates.

Among short-term rates, the federal funds and Treasury bill rates are especially significant. The federal funds rate is an indicator of the supply of excess reserves relative to the demand for them among the banks which participate in the federal funds market. Tightening or easing of reserve positions among these banks is reflected promptly by a rise or decline in the federal funds rate. Once the federal funds rate rises to the discount rate it fails to register any further intensification of reserve pressures. The discount rate acts as a ceiling on the federal funds rate because few member banks will pay more for federal funds than the cost of borrowing from a Reserve Bank. Market rates on Treasury bills reflect the ebb and flow of temporary funds among institutional holders.

Market rates on long-term securities are indicators mainly of the flow of savings in relation to the demand for funds by corporations for capital expenditures, state and local governments for public improvements, and sometimes by the Federal Government to finance a deficit or to refund maturing securities.

Market rates also have the advantage of reflecting changes in both supply and demand. Credit tightness or ease is not determined by changes in supply alone. A larger market supply does not necessarily result in easier credit; it does so only if the increase in supply is not offset by an increase in demand. Neither does a decrease in supply always result in tighter credit; that is the result only when supply decreases more than demand. Rising market rates indicate greater scarcity of supply relative to demand—not necessarily a reduced supply in an absolute sense. Rates decline when supply becomes more plentiful relative to demand, not necessarily because of a larger supply.

Market rates have limitations as indicators of the intensity of credit restraint or ease. They reflect the interplay of demand-supply forces in only a part of the total credit market—principally among large institutional borrowers and investors. Inasmuch as the money and capital markets are not alternative sources of credit to many who borrow directly from commercial banks and other lenders, market rates afford little indication of the availability of credit to or the demand for credit from such borrowers.

Market rates, especially short-term rates, are influenced by purely temporary and sometimes erratic shifts in demand and supply. These short-term fluctuations obscure the trend in market rates, and it is the trend rather than daily fluctuations that is significant as an indicator of the more basic changes in market supply-demand relationships.

Guides for daily decisions

Guides or indicators of restraint or ease are also needed in conducting day-to-day open market operations. The management of the Open Market Account is confronted every day with the problem of deciding whether funds should be put into or withdrawn from the market to prevent market factors from creating stringency or ease that is inconsistent with System objectives. Several types of information are useful as guides for these day-to-day operations.

Statistical indicators. Reserve positions, especially of the money-market banks in financial centers, reflect the ebb and flow of business and financial transactions. The tightening or easing in net reserve positions is a significant indicator of whether System action is needed to supply or to withdraw funds. The usefulness of reserve positions is diminished by the time lag

before actual data are available. Reserve positions yesterday do not provide a satisfactory answer to the question of whether funds should be supplied or withdrawn today.

To overcome this difficulty, daily estimates of reserve positions are prepared, including the principal factors affecting reserves such as float, Treasury operations, gold flows and foreign operations, and changes in currency in circulation. Even though these estimates are carefully prepared, transportation delays and other unforeseeable factors sometimes result in substantial errors. The distribution of reserves and the availability of excess reserves in the federal funds market are other factors to be considered.

As previously mentioned, the federal funds rate promptly reflects changes in reserve pressure or ease among the large banks in financial centers. Market rates indicate day-to-day changes in supply-demand relationships in the money market, but these changes are often the result of temporary factors—such as corporate sales and redemptions of Treasury bills and other short-term Government securities in preparation for dividend and tax payments, and investment of the proceeds of a large bond issue in bills pending more permanent use of the funds. It is extremely difficult to distinguish rate changes which reflect mostly such transitory shifts in supply-demand relationships from those of a more basic nature. And it would be confusing to put funds into the market one day and withdraw them in a day or so to prevent these short-term fluctuations in rates.

The money supply is not a satisfactory guide for day-to-day operations. The time lag before satisfactory data are available is too great and, as already mentioned, daily changes in demand deposits are sometimes quite large. Moreover, daily changes often reflect such factors as float and fluctuations in Treasury balances in the Reserve Banks which usually cancel out in a relatively short period of time.

"Feel" of the market. Men with extended experience in the money market often say that statistical indicators do not tell the whole story. Available statistics often belie the real availability of funds in the market. They may show that funds should be there when the market "feels" tight, or they may indicate that funds are scarce when the market "feels" easy.

What is this feel that experienced participants in the money market talk about? Actually, it reflects the combined effects of bits of information and impressions picked up in a variety of money-market contacts. Feel is based, in part, on what statistics show. It is also based on what available statistics do not show. To illustrate: Are dealers experiencing difficulty in finding funds to finance their position? What are the managers of the money positions of the money-market banks saying as to the availability of funds? Is there a good supply of funds being offered in the federal funds market? What about the market for Treasury bills and other short-term securities? Is it active or sluggish, broad or thin? Is the spread between bid and asked quotations wide or narrow? Is most of the interest on the buy or sell side of the market? These are some of the factors that help to create a "feel" as to the availability of funds in the market—a feel that is sometimes at variance with the statistics. For an experienced operator, a feel of the market, based on both available statistical information and impressions gained from numerous market contacts, is undoubtedly a valuable supplement to the statistics.

Conclusions

Monetary authorities are confronted with difficult decisions in implementing monetary policy.

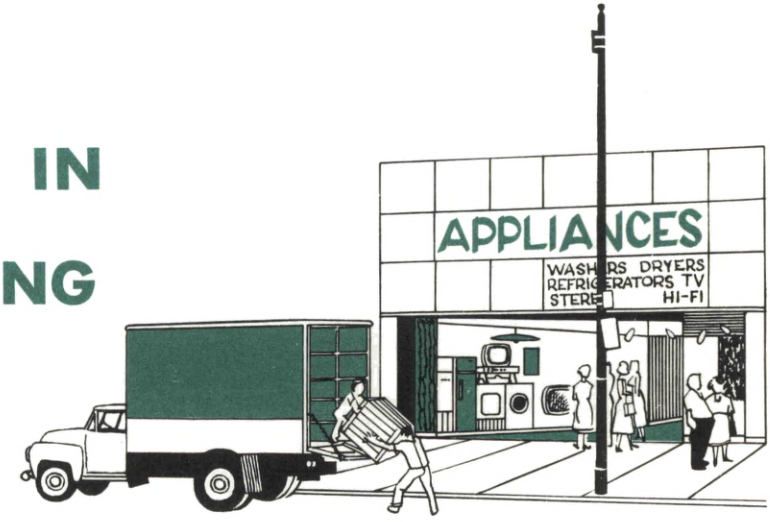
How tight or how easy is credit; and is existing tightness or ease about right from the standpoint of achieving the ultimate objectives of monetary policy? Moreover, changing business and financial conditions alter the degree of restraint or ease that is appropriate. In addition to periodic decisions as to how much restraint or ease, daily decisions are required as to whether open market operations should be used to supply or absorb reserves in order to prevent tightness or ease that is inconsistent with System objectives.

Statistical indicators are useful but inadequate guides in making such decisions. Data on net free or borrowed reserves, the money supply, and market rates of interest, along with other relevant information, are indeed helpful in deciding whether a given degree of restraint or ease continues to be appropriate. Data on daily reserve positions, including estimates for the immediate future, and short-term market rates are useful in making the daily decision of whether open market operations should be used to supply or withdraw funds to avoid undue restraint or ease.

All such data, however, have a serious shortcoming. At best they can serve only as a reasonably accurate measure of the existing degree of restraint or ease. They cannot reveal the amount of restraint or ease that under existing economic conditions would best contribute to price stability and business stability with a reasonably full use of resources.

It is the inherent inadequacies as well as the imperfections in data that make central banking an art rather than a science. The forces relevant to decisions in formulating and implementing monetary policy are too numerous and too diverse to be encompassed in some mechanical formula or in a few statistical series. Information on how to drive an automobile is essential, but skillful driving requires in addition the feel that can be gained only by experience at the wheel. Interpreting factual information and translating it into appropriate monetary actions also require the skill derived from experience.

APPLIANCES IN AN EXPANDING MARKET



The term "consumer durable" means just what it says—consumer goods that last a long time. Though bread and biscuits are consumed in a day, refrigerators, washing machines, and television sets last for years. And this durable quality means that replacement may be put off if more pressing needs for funds arise.

Last year more pressing needs did arise. We were in a recession. People were out of work. Others who were not out of work still were unsure of the future. They preferred to add their dollars to the old savings account rather than invest in a shiny new washer-dryer combination.

Result? Appliance sales declined. But what is deferred in the present must some day be reckoned with. In 1959 we have had a vigorous recovery. Employment has picked up and confidence has returned. Consumers are in a better buying mood. In addition to goods they would normally purchase this year, they are buying many of the things they put off in 1958.

Result: this looks like a banner year for hard goods in general and appliances and entertainment devices in particular.

At midsummer, this was the over-all picture at the national level. For a look at appliance merchandising trends in the Philadelphia Federal Reserve District we have talked with department store executives and representative dealers in some of our larger metropolitan areas. What follows is a composite of their appraisal of the district situation based on selling experiences in recent months.

Business volume is up sharply in appliances

Many more consumers are said to have become "appliance minded" in recent months and with few exceptions merchants report that business volume is running well ahead of year-ago levels. Most retailers also say that the improvement noted since last winter has been pretty much across the board. Nevertheless, some items for seasonal or other reasons have been better performers than others.

Almost everywhere, washers and washer-dryer combinations are said to be leaders in the white goods field. Refrigeration, too, is moving at a fast clip, although the demand for boxes

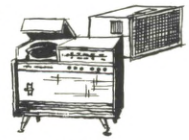
appears more active than for deep freezers. To be sure, hot weather always is a factor in sales of cooling devices because it brings so many more breakdowns in units that have begun to age. Speaking of summertime temperatures, the month of June with its two severe heat waves appears to have done for room air conditioner sales what the whole of last summer failed to do. Most merchants say that ranges, water heaters, and vacuum cleaners are moving satisfactorily as the "bread and butter" items of today's appliance business.

Entertainment equipment moves at a slower pace

Considerable improvement also has been noted in the field of home entertainment devices such as television, high fidelity sound, and radio. But in this area of the market gains have not kept pace with appliance trends. Costly stereophonic reproduction equipment is said to be catching on slowly because of confusion in consumers' minds regarding the proper use of these instruments. This is particularly true of stereo components used in connection with high fidelity units.

As merchants are quick to point out, summertime is not the season to look for great strength in entertainment equipment other than portable radios. Too many people are preoccupied with vacations and a wide range of other out-of-door activities. Prospects for good fall business, however, seem much brighter this year than last. And, as might be expected, a more stable employment situation figures strongly in these calculations. The one "fly in the ointment" is the duration of the nationwide steel strike. A long shutdown might have especially severe repercussions in the entertainment field.

Consumer preferences favor luxury models



A majority of merchants say that the luxury models in both appliances and entertainment lines hold somewhat of an edge over stripped-down units offering mainly utility. They point to this preference as additional evidence that consumers are inclined to spend more freely than at this time last year. You hear most frequently expressions such as "quality minded" and "feature-conscious" in reference to the characteristics of people making up the bulk of store traffic these days.

Brand names also are very important

Going hand in hand with the increased interest in models offering greater convenience and, in the case of some appliances, larger capacity, is a growing preference expressed for brand names. Naturally enough, a well-known manufacturer's name engenders more confidence in the performance of a given piece of equipment than the trademark of one whose products are less widely distributed. Today's buyers rate service and lasting qualities very high on the list of "must" characteristics of whatever item they select.

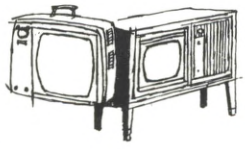
Homebuilding is helping manufacturers more than retailers

Until the advent of so many built-in or appliance-equipped kitchens, a high rate of homebuilding meant considerably more business for the retail merchant. His new and replacement markets both seemed to benefit. The newlyweds were the first-time customers and frequently those who were not so newly wed preferred to make their occupancy of a new home an occasion for replacing one or more pieces of old kitchen equipment. But today too many new houses come equipped with basic appliances

purchased by the builder directly from the manufacturer or a wholesale distributor at prices the average retailer could not hope to meet. On this business most retail merchants, large or small, are by-passed. As one dealer chose to put it, "the best I can hope for is a larger replacement market, and that is some years away."

Price competition is just as keen as ever

To say that the consumer is price conscious in almost the same breath that you describe him as being "quality minded" and "luxury bent" in his shopping habits sounds inconsistent. But merchants say that is not the case. Price-wise, today's consumer is a very well-informed individual. He has learned to recognize values and is out to get quality merchandise, with all the wanted features and a brand name thrown in. All this is expected at an attractive price. The retailer who does not meet all these requirements stands an excellent chance of seeing a prospective customer take his business somewhere else.



. . . and profit margins are under pressure everywhere

Experiences with the operations of the now well-established discount houses have made it imperative for all merchants selling appliances, television, and similar big-ticket items to cut their costs wherever they can. Most of them seem to have found ways of doing just that. Moreover, in today's highly competitive market a smaller mark-up is almost a necessity if the retailer is to stay in the running. That is the consensus of those with whom we have talked. Some merchants say they get around the price-tag problem by offering larger trade-in allowances than a competitor. But most of them hasten to add that this sometimes can be risky business, particularly if a dealer is not properly set up to do a reconditioning job that will make the trade-in a salable article. This all adds up to one thing in the opinion of a great majority of retailers: much more dependence on volume and less reliance on profit margins than was the accepted practice only a few years ago.

Instalment volume continues heavy

Opinions seem to differ somewhat as to the part played by instalment buying this year. Retailers in most of our metropolitan areas, including Philadelphia, think that the popularity of time-payment plans still is increasing. At the same time, however, they mention a surprising number of cash transactions in recent months. Included in these are sales made on a 30-, 60-, or 90-day basis, some of which are later re-written as instalment transactions. A comment made by one merchant appears typical: "More people have cash to lay on the barrel, but they still like to see good balances in their bank statements."

Pressure for easy terms on time payments is not nearly so pronounced as it was over most of last year, according to a majority of the retailers with whom we talked. Some of them even note a tendency to put out more cash at the time of purchase and to complete payments on the balance a little ahead of schedule. Collections generally are said to have improved since the early months of this year and very few merchants mentioned delinquencies or repossessions as current problems.

Inventories are in good shape

Local merchants say they have "licked" the inventory problem posed largely by so much distress merchandise resulting from failures and

slow sales in 1958. The clean-up of old models in both appliance and entertainment lines is said to be proceeding in orderly fashion. Promotional events designed to accomplish this seem to be going off very well and in some cases the consumer response has gone well beyond earlier expectations. An outstanding example of old-model liquidation is room air conditioners, which moved out in a hurry during the June heat waves. Merchants this year all appear thankful that the use of color in the traditional white goods lines is no longer a factor to complicate whatever inventory difficulties they may have had earlier.

1959 has all the earmarks of being a good year throughout

On the basis of their first-half operations, scarcely a merchant contacted hesitated to say that 1959 may very well turn out to be one of the best years experienced for quite a while.

They look for volume to hold up and even increase through the fall when the demand for all entertainment equipment is expected to move out of the doldrums. All merchants seem to realize that heavier spending for houses and automobiles could easily detract from their sales of appliances, television, and similar items. But they have seen no evidence of this so far.

As mentioned earlier, retailers think there is a distinct threat to future business in the steel strike, particularly if it should become a long drawn-out affair. In that case even Christmas holiday demand might be seriously affected. And that would call for a drastic revision of expectations, because right now retailers say they are counting on the 1959 holiday season being one of the best in a long time for these big-ticket items.

Additional copies of this issue are available upon request to the Department of Research, Federal Reserve Bank of Philadelphia, Philadelphia 1, Pa.

NEW PUBLICATIONS

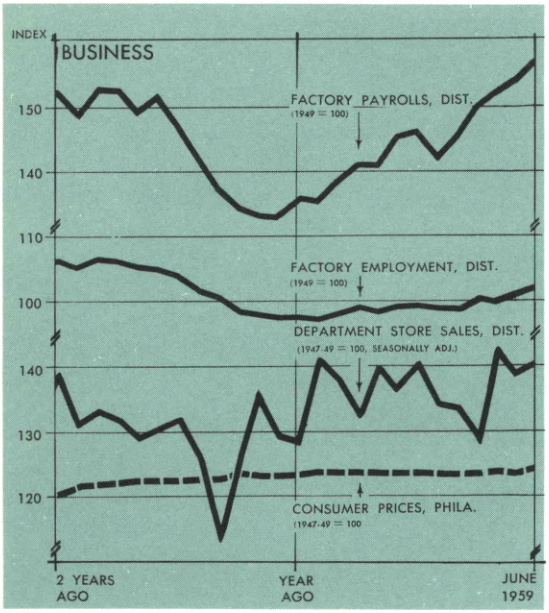
Treasury-Federal Reserve Study of the Government Securities Market is the result of a joint inquiry into the functioning of the Government securities market.

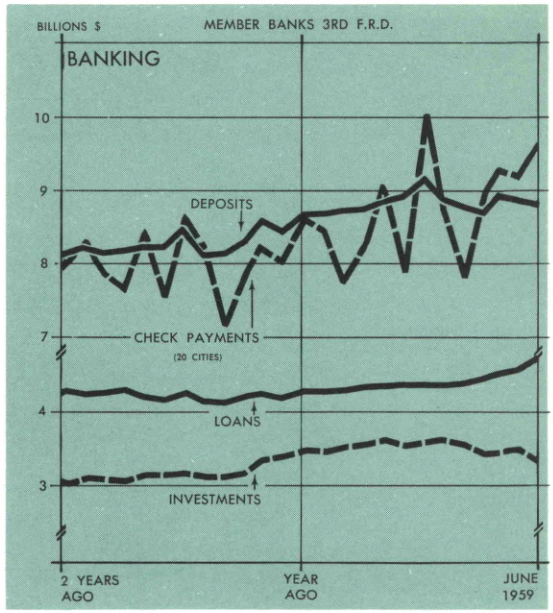
Part I, now available for distribution, consists of two papers; the first summarizes informal consultations with individuals associated with or informed about the market, and the second is a special technical study concerned with the question whether an organized exchange might better serve the public in effectuating the purchase and sale of Government securities.

Part II will be a factual and analytical report on the performance of the Government securities market in 1958, and Part III will deal with specialized and technical subjects suggested by informal consultations and factual records.

The price of each part is $1.00, or $2.50 for the set when all are ordered at the same time, and may be obtained from the Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington 25, D. C. Individual parts will be forwarded as they become available.

FOR THE RECORD...





SUMMARY

	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	June 1959 from		6 mos. 1959 from year ago	June 1959 from		6 mos. 1959 from year ago
	mo. ago	year ago		mo. ago	year ago	
OUTPUT						
Manufacturing production	+ 2	+ 9	+ 5	+ 1	+19	+16
Construction contracts	+ 3	— 6	+11	+ 3	— 4	+12
Coal mining	+ 1	+ 2	+10	+ 1	+ 1	+ 6
EMPLOYMENT AND INCOME						
Factory employment (Total)	+ 1	+ 5	+ 1	+ 1	+ 8	+ 4
Factory wage income	+ 2	+16	+10	....	....	....
TRADE*						
Department store sales	+ 1	+ 9	+ 7	+ 1	+ 9	+ 8
Department store stocks	+ 5	+ 7	....	+ 3	+ 5	....
BANKING (All member banks)						
Deposits	— 1	+ 2	+ 5	0	+ 1	+ 5
Loans	+ 2	+10	+ 7	+ 2	+ 9	+ 7
Investments	— 4	— 5	+ 6	— 3	— 6	+ 5
U.S. Govt. securities	— 5	— 5	+ 6	— 3	— 8	+ 4
Other	— 1	— 4	+ 4	— 1	+ 2	+ 8
Check payments	+ 4†	+12†	+12†	+ 6	+ 4	+ 8
PRICES						
Wholesale	....	....	....	0	0	0
Consumer	+ 1‡	+ 1‡	+ 1‡	0	+ 1	+ 1

*Adjusted for seasonal variation. †20 Cities ‡Philadelphia

LOCAL CHANGES

	Factory*				Department Store†				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change June 1959 from									
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Lehigh Valley	— 1	+ 2	— 1	+14	....	....	....	....	+ 5	— 9
Harrisburg	+ 2	+ 8	+ 4	+19	....	....	....	....	+ 7	+ 5
Lancaster	+ 2	+ 8	+ 1	+16	— 2	+ 3	+ 5	+ 7	+ 1	+10
Philadelphia	+ 2	+ 4	+ 3	+13	0	+11	+ 4	+10	+ 1	+14
Reading	0	+ 8	+ 3	+21	+ 2	+11	+ 6	+ 3	+ 4	+12
Scranton	0	— 1	+ 1	+ 2	— 4	+ 3	+ 2	+ 8	+ 5	+ 2
Trenton	+ 2	+ 7	+ 3	+19	+ 1	+ 4	+12	+ 5	+ 9	— 1
Wilkes-Barre	0	+ 7	0	+13	+ 3	+10	+ 3	— 2	+ 8	+ 7
Wilmington	+ 1	+ 5	+ 4	+16	— 3	+ 9	+ 8	+ 7	+36	+12
York	+ 2	0	+ 5	+11	+ 1	+ 6	+ 3	+13	+ 7	+24

*Not restricted to corporate limits of cities but covers areas of one or more counties.
†Adjusted for seasonal variation.