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# BUSINESS REVIEW

The Foreign Exchange Market  
Restoration in Vacationland



FEDERAL RESERVE BANK OF PHILADELPHIA

## BUSINESS REVIEW

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# THE FOREIGN EXCHANGE MARKET

*Foreign Exchange*

Monday, July 2, 1962

Selling prices for bank transfers in the U.S. for payment abroad, as quoted at 4 p.m., follow (in dollars):

	Monday	Prev. Day
Canada (Dollar) .....	.9244	.9247
England (Pound) .....	2.8085	2.8086
30-day futures .....	2.8067	2.8068
90-day futures .....	2.8031	2.8032
France (Franc) .....	.2041	.2041
West Germany (Deutschemark) ...	.2506 $\frac{1}{4}$	.2506 $\frac{1}{4}$

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“What is the quote on Canadian dollars? I am expecting payment in Canadian dollars in about 60 days, do you think the rate will hold or should I sell for 60 days future delivery?” Other customers inquire as to the current quotation on sterling, French francs, and other foreign currencies. This type of conversation is repeated many times every day in the foreign department of a large commercial bank.

Many business firms and individuals are interested in foreign exchange rates (the prices of foreign currencies), and rates are quoted in the financial section of most large metropolitan papers. A sample of recent New York quotations is shown in the illustration. Changes in foreign exchange rates may decrease (or increase) the number of dollars received by exporters, owners of foreign investments, and others receiving payment in foreign currencies. They may increase (or decrease) the cost of imports, a trip abroad, and other transactions calling for payment in foreign currencies.

Payment in international transactions involves exchanging one country’s currency for that of another. Foreign exchange markets provide the facilities for such exchanges—for the purchase and sale of foreign currencies.

This article deals with the foreign exchange

market in the United States and some of the factors influencing foreign exchange rates.\*

## THE NATURE OF THE MARKET

A foreign exchange market is similar to any other market in that it has stock-in-trade, buyers and sellers, and facilities for bringing buyers and sellers together.

## Institutional structure

The foreign exchange market is not an organized market such as a stock or commodity exchange. There is no single trading place where orders are executed. It is an over-the-counter market similar to that for Government securities, and transactions are executed over the telephone.

The core of the market in the United States consists of a relatively small number of commercial banks and agencies of foreign banks in New York City. Some of the larger banks in other financial centers buy and sell foreign exchange and maintain positions in some of the major foreign currencies. The bulk of the foreign exchange business, however, is handled by a dozen or so large New York City commercial banks.

\* For a more complete analysis, see Alan R. Holmes: “The New York Foreign Exchange Market,” Federal Reserve Bank of New York.

The larger banks with active foreign departments maintain deposit balances abroad in the principal foreign currencies and have skilled foreign exchange traders who do the actual buying and selling of foreign exchange. In rendering services to their customers, these banks are constantly engaging in transactions which add to their foreign currency deposits abroad. They buy bills of exchange from business firms, purchase travelers' checks payable in foreign currencies, and buy dividend warrants and bond coupons from United States investors owning foreign securities. Sometimes United States banks sell dollars to foreign banks wanting to build up their deposit balances in the United States. Other foreign exchange transactions with customers tend to draw down their deposit balances abroad. They may sell drafts payable in foreign currencies to importers and to United States investors making payment for foreign securities. Purchases and sales of a foreign currency seldom completely offset each other, with the result that a bank's position may increase one day and decline the next.

Banks dealing in foreign exchange want to maintain working balances in foreign currencies sufficient for day-to-day operations, but try to avoid excess balances because of the risk of fluctuations in foreign exchange rates. Frequent adjustments in foreign exchange positions are therefore necessary.

A bank may turn to other United States banks to dispose of an excess or cover a shortage in a foreign currency; however, banks do not deal directly with each other. Instead, they deal with foreign exchange brokers whose primary function is to put banks and other foreign exchange dealers with excess positions in touch with those with shortages. The broker receives a small commission for his service of bringing buyers

and sellers together. He does not buy and sell as a principal.

United States banks and other foreign exchange dealers may also use foreign exchange markets abroad to adjust their positions. A bank with too much sterling may request its London correspondent to sell sterling for dollars. This may be the most convenient method of adjustment, especially near the close of the business day or if there is little demand here for sterling. If, on the other hand, a United States bank runs short of sterling it may buy sterling from or through its foreign correspondent.

A United States bank may adjust its foreign exchange position through swap transactions with a foreign correspondent, the United States bank crediting the account of its foreign correspondent in dollars and the foreign correspondent crediting the United States bank with an equivalent amount in foreign currency. Under current practices of adjusting positions, a demand for foreign currencies in the United States may soon show up in the form of an increased supply of dollars abroad; or a demand for dollars abroad may result in an increased supply of foreign currencies in the United States.

Smaller banks, which do not maintain balances abroad, can still meet the foreign exchange needs of their customers. Such banks may acquire and dispose of foreign exchange for their customers through city correspondents which do participate directly in foreign exchange markets. Through correspondent relationships, the bulk of foreign exchange transactions is funneled to a few large banks which maintain foreign balances and deal directly with banks abroad.

Settlement between United States banks and foreign banks is now made mainly by debits and credits to deposit accounts. The dollar has become the most widely used currency in inter-

national transactions, and New York City has become the leading international money center. Consequently, foreign banks that deal actively in the major currencies maintain deposits in New York City banks, and large United States banks with an active foreign exchange business maintain deposits abroad in the principal foreign currencies.

### **Stock-in-trade**

A frequent question is, what is actually bought and sold? The answer is foreign currencies or claims payable in foreign currencies, commonly referred to in the market as foreign exchange.

The bulk of the volume consists in the transfer of deposits in foreign currencies from one owner to another, such as sterling deposits in London banks or franc deposits in French banks. Deposit transfers are authorized by cable and by mail. Checks, drafts, and coupons payable in foreign currencies are also bought and sold in foreign exchange markets.

There are some transactions in foreign coins and paper money. Tourists going abroad sometimes buy small quantities of foreign coins and currency to use upon arrival pending such time as they may conveniently cash a traveler's check. But the volume of transactions in foreign coins and currency is small.

### **Sources of demand and supply**

The fact that a large part of our exports and imports is invoiced and paid in dollars means that a large part of the foreign exchange transactions involved in our foreign trade bypasses the United States market. The exchange of foreign currencies for dollars is made mostly in foreign exchange markets abroad rather than in the United States.

The supply of foreign exchange offered for

sale in the United States market comes from several sources. Payment for some of our exports is still by means of drafts drawn on foreign banks and payable in foreign currencies. Such drafts are sold to United States banks or other foreign exchange dealers. Drafts payable in foreign currencies are sometimes drawn in payment of securities sold abroad and by United States companies remitting interest, dividends, and profits from overseas branches and subsidiaries. Foreign tourists and visitors in the United States may cash travelers' checks payable in foreign currencies or draw drafts in foreign currencies under letters of credit. Speculators may sell foreign exchange purchased previously and, of course, United States banks which maintain balances in foreign currencies abroad also sell foreign exchange to meet demands of their customers.

Basically, the demand for foreign exchange comes from those needing to make payment abroad. American importers buy drafts to pay for goods invoiced in foreign currencies. This is still a common method of payment in certain commodities, such as rubber, jute, and tin, which are often invoiced in sterling, and imports of Swiss watches which are usually invoiced in Swiss francs. Other sources of demand in the United States for foreign exchange are investors desiring to pay for securities purchased abroad; United States companies remitting interest, dividends, and profits on funds borrowed from abroad; American tourists traveling abroad; agencies of foreign banks desiring to return funds previously transferred here; and speculators who buy foreign currencies expecting to sell them later at a higher price.

The mechanics of making payment should not obscure the fact that, except for unilateral transfers, international transactions result in the

exchange of one currency for another. United States payments abroad supply dollars to foreigners—they result in the conversion of dollars into foreign currencies or transfer the ownership of dollars to foreigners. Receipts from abroad (foreign payments to the United States) result in an increase in foreign balances owned by Americans or a reduction of dollar deposits owned by foreigners. Therefore, a net deficit in the United States balance of payments tends to build up deposits owned by foreigners in United States banks; a net surplus tends to build up our deposits abroad in foreign currencies.

### **Foreign exchange rates**

Foreign exchange rates are prices—prices of foreign currencies expressed in terms of a country's own money. Recent New York quotations as shown in the illustration were: pound sterling \$2.8085, Canadian dollar \$0.9244, French franc \$0.2041, and German mark \$0.2506¼.

A foreign exchange rate reflects demand and supply forces in the market for a particular foreign currency. Rates fluctuate, often during the course of a business day as the demand-supply relationship shifts. An increased demand for sterling may cause the price to rise, say, from \$2.80 to \$2.81; or an increase in supply in the New York market might lower the price from \$2.80 to \$2.79.

Wide fluctuations in foreign exchange rates increase risk, and discourage trade and international financial transactions. To illustrate: a jump in the price of sterling from \$2.80 to \$3.00 would tend to raise the cost of imports from England even though commodity prices there remained the same. A United States importer contracting to buy English goods totaling 100,000 pounds sterling would have to pay \$300,000 instead of \$280,000. The English

importer, on the other hand, would find United States goods cheaper in that he could get \$3.00 worth for a pound sterling instead of \$2.80.

Countries belonging to the International Monetary Fund agree to maintain market rates within a range of 1 per cent above and 1 per cent below the established par values of their currencies. Some countries maintain market rates of their currencies within even narrower limits. The par value of sterling is \$2.80, and the upper and lower limits are fixed at \$2.82 and \$2.78. The fact that most countries belong to the I.M.F. and have agreed to stabilize the value of their currency means that most foreign exchange rates fluctuate only within narrow limits.

### **FORWARD EXCHANGE**

The major foreign currencies can be purchased and sold for future as well as immediate (“spot”) delivery. Futures transactions are commonly referred to as forward exchange. The forward exchange market is similar to the futures market for commodities. Foreign currencies can be bought and sold for delivery at a specified future date and at a price agreed upon when the contract is made. Purchases and sales of major foreign currencies for delivery in 30, 60, 90 days, and even up to six months are common in the United States market. Occasionally, futures transactions for longer terms are negotiated, but foreign exchange dealers enter into such contracts only when they can arrange to hedge their position.

### **Uses of the forward market**

The forward exchange market makes it possible for those engaging in international transactions to protect themselves against the risk of exchange-rate fluctuations. To illustrate: an importer may

contract to buy goods from an English exporter for 1,000 pounds sterling which at the current rate of exchange would amount to \$2,800; if, however, the price of sterling has gone up by the time the goods arrive and payment is to be made, the cost will be more than the importer anticipated. When he contracts to buy the goods he could protect himself against the exchange-rate risk by buying at the current forward rate 1,000 pounds sterling for delivery at the time he is to make payment for the goods. An exporter who has priced his goods in a foreign currency to yield a certain number of dollars may likewise find his dollar proceeds reduced because of a drop in the price of the foreign currency. He can protect himself by selling this foreign currency for future delivery or, in the terminology of the market, by selling forward exchange.

An exporter may not be able to determine in advance the exact date his goods will be shipped and therefore when he will have his foreign draft for sale. Importers also are often unable to determine the day on which they will need to make payment abroad. Because of such uncertainties, foreign exchange dealers enter into forward contracts giving the seller or buyer the option of offering or taking delivery on his future contract at any time within a period of one or two weeks. Rates on option contracts are likely to be a shade above or below comparable futures maturing on a fixed date.

Commercial banks and other foreign exchange dealers use the forward market to hedge their positions in foreign currencies. If a bank buys 100,000 pounds sterling in the spot market, it can cover its position by selling sterling forward. If the price of sterling rises, and spot and forward rates move together, the gain on holdings of 100,000 pounds sterling would offset the

loss on the forward transaction. If, on the other hand, the price declines, the gain on the forward transaction would offset a loss on its sterling holdings acquired at a higher price. Dealers also use the spot market to hedge their position in forward contracts.

United States purchasers of foreign securities may cover the exchange risk involved through the forward market. When interest rates on short-term investments are higher abroad, as they have been recently, there is an inducement to invest in short-term foreign assets to take advantage of a higher yield. A United States investor buying 90-day British Treasury bills would have to buy spot sterling to pay for them. At maturity 90 days hence, he would receive the face value of his bills in sterling. If in the meantime the price of sterling has declined, he would suffer a loss when converting his sterling into dollars. The investor could protect himself against loss by selling sterling for 90 days future delivery at the same time he purchases British Treasury bills.

Speculators use the forward exchange market not to hedge against the risk of exchange-rate fluctuations but to profit from them. A speculator would buy forward exchange when he expects the rate to rise, hoping to sell the currency or at least close out his forward contract at a profit. He would sell for future delivery (sell short) if he expects the price to fall. If the price does decline, he can acquire the currency for delivery at less than his selling price. Willingness of speculators to take risk makes it possible for others to cover their risk in the forward market.

### **Relation between spot and forward rates**

Unless the spread between spot and forward rates for a foreign currency is about equal to the difference in comparable interest rates in the

United States and the foreign country, there is an inducement to shift funds to take advantage of the higher rates. For example, if the spot price of sterling is \$2.81 and three-month forward sterling is \$2.79, the discount on forward sterling is equivalent to 2.85 per cent interest at an annual rate.\* If the current yield on three-month Treasury bills is 3 per cent and the yield on three-month British Treasury bills is 5.85 per cent, the cost of hedging by selling 90-day forward sterling (2.85 per cent) absorbs the difference in yield. A United States investor who covers his exchange risk would find the net return on British bills the same as that on United States bills. A 6 per cent yield, however, on three-month British bills would enable a United States investor to cover his foreign-exchange risk and get .15 per cent higher return on British bills. Under these circumstances, United States investors could obtain a higher net return on British bills, and short-term funds would likely flow from the United States to England.

An outflow of funds to take advantage of the higher net return on British bills would tend to eliminate the profit opportunity. As already indicated, a United States purchaser of British bills would buy spot sterling to pay for the bills and sell 90-day forward sterling to cover his exchange risk. The resulting increased demand for spot delivery and increased supply of forward sterling would widen the spread between the two rates and increase the cost of hedging an investment in British Treasury bills. The outflow of short-term funds would tend to raise interest rates here and lower them in England. Thus, interest-arbitrage transactions narrow the differential in interest rates and widen the spread between spot and forward rates.

\*  $\frac{\$2.81 - \$2.79}{\$2.81} \times 4 = 2.85\%$  at an annual rate.

Interest-arbitrage transactions, although operating in that direction, do not always maintain equality between interest-rate differentials and the cost of covering the exchange risk. Some investors are usually willing to buy higher-yielding foreign securities without covering the exchange risk. Speculators, as we have seen, buy and sell foreign exchange hoping to profit from rate fluctuations. Moreover, many investors in the United States, either because of legal restrictions or unfamiliarity with foreign exchange practices, are unable or unwilling to engage in interest-arbitrage transactions. For reasons such as these, the volume of arbitrage transactions is often insufficient to maintain the spread between spot and forward rates at so-called interest-rate parity.

#### **FOREIGN MARKETS IN DOLLARS**

A recent development is that some foreign banks accept deposits denominated in dollars, and to some extent these deposits serve as a means of payment. The most important "foreign market" in dollars is in London, with smaller markets in some of the financial centers of Western Europe and in Canada. The market in Europe is often referred to as the Euro-dollar market.

A distinguishing feature of foreign markets for dollars is that banks accept deposits denominated in dollars and make dollar loans to customers. In the terminology of the market, foreign banks "accept" deposits denominated in dollars and "place" (lend) dollars with their customers. In short, deposits in foreign banks denominated in dollars are transferred from owner to owner, and borrowed and lent much as deposits in United States banks.

Several types of transactions are fairly common in foreign markets for dollars. Foreign importers may borrow dollars from a foreign



bank to pay United States exporters. Sometimes importers borrow dollars to pay for exports from countries other than the United States.

Foreign markets for dollars developed, in part, because they offer certain advantages to importers and borrowers. For one thing, these markets may serve as a supplement to lines of credit with United States banks and thus enable foreign borrowers to obtain more dollars. Residents of Communist countries have readier access to dollars in foreign markets than in the United States. International differences in interest rates may enable borrowers to get dollars more cheaply in foreign than in United States markets.

Foreign owners of dollars also derive advantages; otherwise, they would not offer their dollars in foreign markets. Foreign banks sometimes pay higher rates on deposits than United States banks. Commercial banks in the United States are prohibited from paying interest on demand deposits and the ceiling on time deposit rates is frequently below rates paid abroad. Another advantage is that rates on Euro-dollar deposits are commonly quoted in four time classifications: call, seven-day, one-month, and three months. This practice is especially attractive to owners of dollars wanting a time deposit for only a short period.

Foreign branches of United States banks recently began participating in the Euro-dollar market. These branches have usually paid more on dollar deposits than rates paid in the United

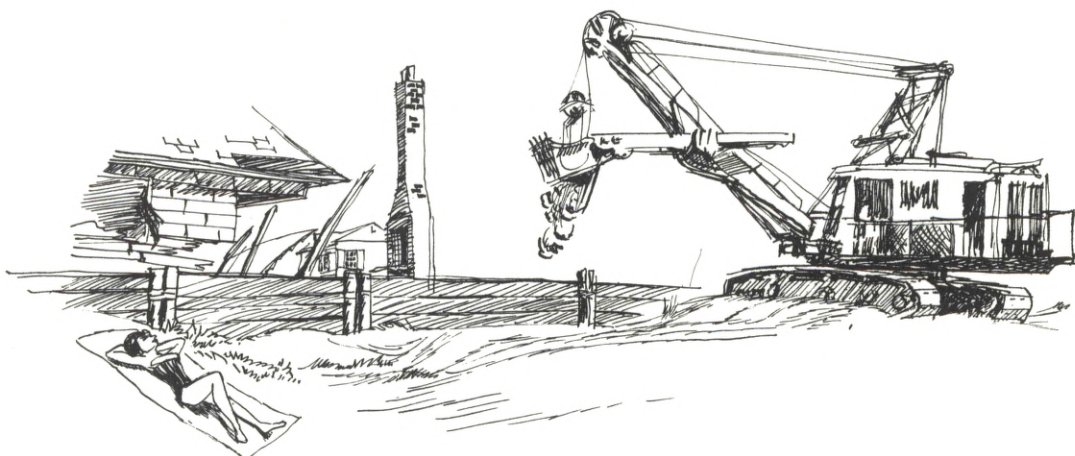
States on time deposits. It has been estimated that branches of United States banks hold a substantial part of total dollar deposits in London. Their dollar deposits are used to make loans to business firms wanting dollars, and to make advances to their head offices in the United States.

### **CONCLUSIONS**

Foreign exchange markets are an integral part of the modern world economy. There is no single monetary unit that is generally acceptable in international transactions. As a result, settlement of such transactions usually requires exchanging one nation's currency for another's. Foreign exchange markets, in which foreign currencies may conveniently be bought and sold, promote trade and financial transactions among countries.

Even though foreign exchange markets facilitate settlement, they do not alter the basic fact that international transactions are essentially an exchange of goods and services. Countries with balance-of-payments surpluses tend to accumulate deposit balances in countries with deficits. In effect, the surplus countries are exchanging goods, services, or capital for deposits in foreign banks, or other foreign short-term assets. Foreign deposits and short-term investments, however, are not of value in themselves. They are of real value only to the extent they meet a need for working balances and monetary reserves, or can later be used to acquire goods and services.

# RESTORATION IN VACATIONLAND



Vacation time is at hand, and what is more delightful than a cottage at the shore or a cabin in the hills! Thousands go down to the sea where the waters surrender reluctantly to the land, leaving long stretches of sand alternately washed and dried in flowing and ebbing tides. Other thousands go up into the mountains, where the landscape is laced with placid lakes and rippling streams. The ideal vacationlands are where land and water meet under sunny skies and gently blowing winds.

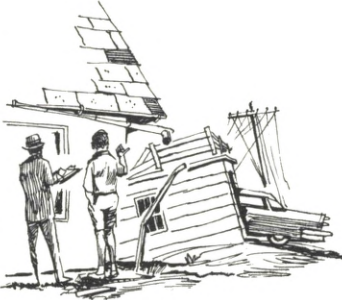
Where land and water meet, however, great danger lurks when Nature gets angry. High winds, high tides, and flash floods bring destruction and death when vacationlands are visited by hurricanes or furious nor'easters. In 1954, Carol struck a blow at New England. In 1955, Diane brought devastation to the Poconos. This year a mad nor'easter wrought havoc on our nearby Delaware and New Jersey resorts. Though the damage to the stricken areas is terrifying, it is amazing how quickly they recover.

Seashore resorts in New Jersey and Delaware were hit hard by the March, 1962 storm which caused 21 casualties and over \$100 million of property damage. Unfortunately, most of the home owners who suffered partial or complete destruction of their properties were not covered by insurance against water damage, which was apparently the greatest cause of loss. Damage to public property is compensable through several channels, but available funds fall far short of needs.

Our pre-season survey of the resort business shows prospects in the Poconos as good or better than usual, but in some sections of the seashore optimism is tempered with caution. Though remarkable progress has been made in reconstruction of storm damage to rental housing, boardwalks and associated facilities, early vacation shoppers were loath to sign up for advance reservations and were more disposed to settle for week-ending. A more complete story of the winter storm and the summer's prospects follows.

## THE UNFINISHED TALE OF "CAT 31"\*

CAT 31, the wickedly capricious nor'easter of March 6-8, 1962, is still a continuing story. Its waterlogged wake trails an unfinished tale of immense and as yet not fully measured costs. Its aftermath involves past, pending, and proposed legislation; construction in progress, and controversy in prospect; and governmental agencies at all levels. Banks, insurance companies, public utilities, the American Red Cross, and private citizens have intertwining roles. The middle of the narrative is just now beginning; an end to the story may not be written until generations have passed, depending on the twist the tale takes.



but once in 80 years. First, the moon was new—a lunar phase that causes high tides. Second, the low-pressure system responsible for the precipitation brought with it winds gusting up to 72 m.p.h., and these whipped the tides still higher. Third, turbulence in the upper air currents prevented the low-pressure system from following its customary course out to sea and instead held it along the coast continuously for three days.

Each succeeding tide flooded higher than the one 12 hours earlier. In the words of one eyewitness, "The tide just couldn't seem to get back out to sea, and finally the water just overran everything." Water intrusion was noted from New England to the Carolinas, in lesser degree at the extremities, and with its most devastating focus on New Jersey and Delaware.

### New Jersey hardest hit

There are few final and accurate statistics available to illustrate the enormity of the storm loss in New Jersey. The several sources offering appraisals differ in detail, and much enumerating is still taking place. But by making judgments and projections of surveys compiled by various agencies involved,† these tragic numbers come to light:

#### *Private loss*

14 persons killed, more than 1,300 injured or ill.

1,360 dwellings, 579 other buildings lost or totally destroyed; 14,000-plus dwellings and buildings damaged.

Upwards of 40,000 insurance claims, esti-

### Born in innocence

The weather forecast on Monday, March 5, for Atlantic City and vicinity read: "Cloudy today and tonight with a chance of some rain developing this evening. Mostly cloudy and cooler on Tuesday (March 6th)." But the predicted rain of Monday night also brought with it snow, sleet, and wind. Flood tides unexpectedly rose 10 feet above normal, and residents soon understood that something unusual was happening.

What transpired was a coincidence of three meteorological phenomena, estimated to occur

\* "CAT 31" derives from insurance terminology. The National Board of Fire Underwriters designates a disaster a "catastrophe" if the insured damage to fixed properties, in any one state, is estimated to be in excess of \$1 million. It also assigns a serial number to the catastrophe. This practice, begun in 1949 with a hurricane in Texas, has carried through one 99-number cycle and is now in the second such series. The storm of March 6-8, for New Jersey, was thus termed "Catastrophe #31," inevitably shortened to "CAT 31."

† Including the Division of Civil Defense and other New Jersey agencies; U. S. Army Corps of Engineers and other federal agencies; banks, public utilities, insurance companies; and an excellent human compilation by the Red Cross.

mated in mid-June to result eventually in payments in excess of \$10 million.

Public utilities expenditures for service restoration and replacement of property and equipment, more than \$2 million.

Red Cross expenditures for individual and mass care, \$650,000 including grants-in-aid for dwellings and furnishings, \$400,000.

Over-all private loss, New Jersey: \$45 million-plus.

*Public loss*

It is not now feasible to apportion public loss into the many categories affected. Some "loss" is final, in that it may never be restored; some "loss" represents repair and replacement costs; some "loss" represents diversion of funds, etc. Yet it can fairly be said that the great area of public loss in New Jersey concerns beaches and their protective works—some 70% of the total.

Over-all public loss, New Jersey: \$35 million-plus.

**Delaware suffered proportionately**

Delaware sustained much less storm damage than New Jersey. But merely to list naked numbers would overlook the fact that Delaware is little more than one-fourth the size of New Jersey, and that compared with 100 miles of exposed shoreline in New Jersey, Delaware has only 55 miles exposed. In relative terms, Delaware also suffered grievously. (Statistics are subject to the same qualifications as those for New Jersey.)

*Private loss*

Seven persons killed.

316 dwellings, 25 farm buildings, 175 other buildings lost or totally destroyed; 3,600-plus structures of all types damaged.

"Code 6" crop damage—a U. S. Weather

Bureau term that covers losses ranging between \$500,000 and \$5 million.

More than 2,600 insurance claims—no estimate of eventual payments.

Red Cross expenditures for individual and mass care, \$70,000 including grants-in-aid for dwellings and furnishings, \$45,000.

Over-all private loss, Delaware: initially estimated at \$11.2 million, now believed to exceed \$15 million.

*Public loss*

Over 90% of the private and public loss in Delaware is confined to one county—southernmost Sussex.

Over-all public loss, Delaware: \$20 million.

**The second shock**

As the initial shock of CAT 31 receded along with the flood waters, property owners began to assess their losses and marshal their assets. They searched out their insurance policies . . . and then the second shock of the storm poured over many of them. Evidently, if they read their policies right, the great bulk of damage to their homes, caused by wave-wash, tidal water, flooding, was *not* covered. Water damage was specifically excluded. Thus begins a lengthy chapter in the Tale of CAT 31.

As policyholders soon realized to their dismay, homeowner-type insurance policies, with extended coverage, embraced about everything but water damage. Losses from fire, explosion, falling objects, wind damage are covered. Even small boats roofed over are "covered." Comprehensive automobile insurance covers auto loss for whatever reason. "Wet marine" policies cover boats, docks, piers, bridges from water damage. But when it comes to fixed property—homes—only a wave-wash endorsement covers water damage, whether wind-driven or rising.

### WAVE-WASH ENDORSEMENTS

Insurance coverage against water damage to fixed property goes back some 20 years. Following the hurricanes on the East Coast in 1944, insurance companies offered protection against water damage in the form of endorsements to regular policies. But these were necessarily expensive, premiums ranging from \$1.50 to \$4.50 per \$100 coverage, depending on the location of the property and other factors. Usual homeowner policies affording fire and extended coverage, but not water damage, averaged about 50 cents per \$100 coverage. The few wave-wash endorsements taken out then were soon lapsed by the policyholders when succeeding years passed flood-free.

In 1951, floods in Kansas and Missouri caused insurance companies to re-examine their position on flood insurance. An engineering firm was hired to carry out a technical phase of the study. Based on the engineers' findings, it was decided that insurance against the peril of floods could not successfully be written.

The question lay dormant until August, 1955, when floods caused severe damage in the North-eastern states. Again, insurance companies employed engineers to re-check their position, and the study was broadened to investigate meteorological and other causative factors.

Influenced by the results of these engineering studies, insurance companies concluded that "specific flood insurance covering fixed-location property in areas subject to recurring floods could not feasibly be written because of":

1. The certainty of loss inherent in floods (as opposed to the "uncertainty" or accidental loss in regard to fire, explosion, falling objects, etc.).
2. The catastrophic nature of floods.
3. The reluctance or inability of property owners to pay the high premiums necessary to make such insurance self-sustaining.

These reasons have latterly been supplemented by these adducements:

4. It is not practicable to include flood insurance with other coverage on fixed-location property generally, because while other natural disasters are unpredictable as to locale, floods do, and will, recur in a given area whenever conditions there are causative.

5. Mandatory flood coverage for all property owners, including those beyond the vulnerable

area, would manifestly be unfair, and is not consistent with a prime principle of insurance—namely, to spread the risk only among those subject to the risk.

### Federal insurance—alive, but barely

Insurance aid from the Federal Government offers little immediate promise to victims of CAT 31, although such insurance is the law of the land. In 1956, Congress passed the Federal Flood Insurance Act, setting up the Federal Flood Indemnity Administration for just such emergencies as the storm of March 6–8. But Congress did not appropriate funds to activate the program then or since.

Disasters subsequent to 1956 have caused periodic attempts to resuscitate FFIA. The latest attempt is a resolution of the Conference of Governors of Atlantic Coast States, meeting in Atlantic City, April 18, petitioning President Kennedy to ask the Congress to revive FFIA. The resolution is now under study, and is another unfinished chapter in the story.

### Current insurance status

Over two-thirds of the insurance claims arising from CAT 31 have been closed; but many of the remaining claims are sizable and are the subject of dispute. The crux of the controversy is wind damage (covered) versus water damage (excluded). Who is to say how much wind damage was done to a house before it washed out to sea? All parties concerned agree that some claims eventually will go to litigation, that some will still be unresolved at year's end.

Very few wave-wash endorsements were in effect in New Jersey at the time of the storm; an officer of a large insurance company says "surprisingly few." He finds this not at all dis-

turbing, for, despite their high cost, wave-wash endorsements have "proved unprofitable."

Insurance companies have found no new circumstances in CAT 31 to alter their decision that flood insurance cannot be privately written successfully. They hold that if flood insurance is to be written it must be Government-subsidized.

### **Federal aid—Office of Emergency Planning**

In the public-loss sector there are more avenues to financial reimbursement for storm damage than in the private area. Many local, state, and federal instrumentalities contribute toward relief, restoration, and repair of public facilities. In the van of these agencies is the Office of Emergency Planning.

When the President has declared a disaster area to exist, OEP can provide federal financial assistance to state and local governments for these purposes:

- Protective measures and debris clearance.

- Health and sanitation emergency measures.

- Emergency repairs and temporary replacement of streets, roads, bridges, dikes, levees, and drainage facilities.

- Emergency repairs and temporary replacement of public buildings, plants and equipment.

There are two key words that limit OEP's endeavors: the first is "public," which in general prohibits repair to private facilities. The second is "temporary," which has come to mean that extent necessary to provide time for more permanent repair and *not* to construct better facilities than existed prior to the disaster.

Following CAT 31, OEP allocated \$10 million to New Jersey; nothing to Delaware. This allocation virtually exhausted OEP's funds, and as of mid-June the Congress has yet to vote

additional monies to OEP. Half of the \$10 million is earmarked for reimbursement of the U. S. Army Corps of Engineers, the remaining \$5 million for municipal projects employing private contractors or state or municipal employees.

Ten million dollars falls far short of the applications for OEP aid from New Jersey, let alone those from Delaware and other affected areas. By June 15, New Jersey had processed 125 applications for municipalities, exclusive of Corps of Engineers' work, totaling \$22.5 million. Delaware had by then processed 61 applications of both kinds, totaling \$4.4 million. At mid-June, New Jersey had received about \$2.5 million from OEP; Delaware nothing. Some local officials feel that Congress has no alternative but to vote the additional funds on grounds that there is no difference in the kinds of projects already paid for and those for which there are no current funds.

### **Federal aid—Small Business Administration**

Another federal agency that can aid in disasters is the Small Business Administration. It cannot give funds but can lend funds at 3 per cent interest to individuals, businesses, and nonprofit organizations for the purposes of repair and replacement of homes, furnishings, buildings, fixtures, machinery and equipment, and inventory. Commercial banks, at their option, may or may not participate in these loans.

Soon after CAT 31 struck, the SBA opened local offices within the affected area, staffed by its own employees and, in large number, by personnel on loan from commercial banks and the Federal Reserve Bank of Philadelphia. Under its Disaster Loan Program, the SBA, as of June 14, had approved 862 applications from New

Jersey and Delaware for loans amounting to \$9 million. Of these, 343 were for homes (\$1.1 million) and 519 for businesses (\$7.9 million). The great majority of these applications was from New Jersey. The largest single loan (\$585,000) was made to Steel Pier, Atlantic City.

Commercial bank participation in these loans is estimated to approximate 2 per cent of the total \$9 million. One reason for this modest participation is that the purpose of the SBA is to make loans that private lenders will not make. Banks find SBA home loan participations not particularly attractive because of the 3 per cent maximum interest charge imposed by the SBA, and sometimes because of the lengthy terms of such loans. Banks may charge as much as 6 per cent on their share of SBA participations for business loans, and much of New Jersey and Delaware banks' current participation is concentrated in the business category.

### **State and local financing**

State and local sectors lend themselves least readily to accurate description and statistical tabulation. Each day seems to bring a changed plan, a revised total, an amended ambition, a different schedule.

This is not a criticism. On the contrary, as far as they could the states have moved with alacrity and objectivity, and generally so have the municipalities. But their interdependence makes it difficult to resolve many issues stemming from the storm. The basic question of whether to be content with just essential, and temporary, restoration or whether to extend restorative projects to a permanent basis cannot be answered independently by either a state or a municipality. What a municipality is able to do depends on what its state will do. What a state is able to do depends on what the Federal

Government will do. The problem is one of simultaneous equations with each factor now unknown or at best an approximation.

### **Attempts at answers**

The State of New Jersey, most damaged of all the states by CAT 31, among other things, has:

Extended its horse-racing season, earmarked revenues from the extension to storm-damage repair.

Voted a "Special Beach Erosion Fund" of \$4 million, to provide matching funds to municipalities, out of the general treasury.

Voted a "Storm Relief Fund" of \$2.5 million, to provide matching funds to municipalities, out of the general treasury.

Voted to waive local financial participation in the special beach erosion and storm relief funds if 10 per cent or more tax ratables were lost.

Empowered the Commissioner of Banking to make it possible for financial institutions to ease mortgage terms in several respects for properties within the disaster area.

Similarly, local governments have disbursed budget surpluses to begin storm repair, have diverted funds from other projects to storm repair, have begun to issue bonds, and have attempted special assessments. But these measures, as those of the state, serve only to underscore the root question: Ultimately, where's the money coming from?

### **One clear area**

Among the concerns of the Federal Reserve Bank of Philadelphia is the effect of the storm on commercial banks within the Third District. Precise evaluations could be made, and the status of the banks is clear. The banks suffered only minor physical damage. Determined and in

some instances heroic efforts by bank officers and employees kept the banks in service almost without interruption throughout the storm.

Commercial banks have little exposure to loss on mortgaged properties in the affected areas. Commercial bank policy concerning mortgages on shore-front property is conservative—it requires substantial equity, assured ability to repay. Surveys by state banking authorities and individual banks indicate that while some stretch-out of mortgage terms may be expedient, there will be little eventual loss.

There is general agreement that the bulk of mortgages on shore-front properties is held by

individuals and by financial institutions other than commercial banks. While there may be more loss in this sector, judgment bonds accompanying mortgages offer substantial protection to mortgagees against abandonment of property.

Direct loans by commercial banks were somewhat higher than the normal seasonal upturn because of the storm but well within the banks' own lending capabilities. (Borrowings by member banks from the Federal Reserve Bank of Philadelphia were nil.) There was no significant or sustained run-off of deposits following the storm; most banks showed a higher, not a lower, deposit structure for comparable dates in 1961.

## RESORT PROSPECTS

In addition to the first shock of the big storm—the loss of life and property destruction—and the second shock, the discovery that much of the damage was not covered by insurance, was a third potential shock—the loss that might be suffered in the resort business, so important to the seashore economy. That question was a point of special inquiry in our early-season survey just completed.

Though Cat 31 left in its wake shifted shorelines, twisted boardwalks, weakened bridges, teetering buildings, and roadways buried under tons of sand, “operation clean-up” wrought unbelievable restoration in the months succeeding the catastrophe. Just prior to the opening of the season, bankers and businessmen along the coastline reported that sufficient progress had been made to accommodate the expected vacationers. Early reservations were somewhat slow but it is believed that the inevitable hot and humid days may bring near-capacity crowds as usual.

In the Poconos, where the weather has been



on its good behavior, a busy vacation season is anticipated. On the basis of early inquiries and bookings, the Poconos should have one of the best, if not a record, year.

### Reconstruction progress encouraging

Storm-damaged areas are making a remarkable recovery. There are exceptions, but that is the over-all picture at the seashore. In places where property damage was relatively superficial, needed repairs were completed in short order. But where damage was more basic, it is taking much more time for complete restoration.

Housing accommodations are said to be in fairly good shape even in some of the hardest-hit areas. All-out efforts are in progress to make beach-front facilities more attractive to this



year's vacationers who will be arriving for their annual sojourn of "fun in the sun." Washed-out bathing beaches have been restored in some places; in others, work is being pushed as rapidly as possible. Most resorts have either rebuilt or are rebuilding their boardwalks. Finishing touches are being applied now to get adjacent stores and amusement facilities in better shape for the summer's influx of visitors. Heavy engineering projects like rebuilding flattened sand dunes and reconstructing jetties and breakwaters have been the real time-consumers in this tremendous clean-up job.

### **Transient business looks good**

Some fine early-season weather seems to have prompted heavier week-end traffic to many of our resort areas this year. Even before Memorial Day, popular vacation spots in the mountains and at the seashore were playing host to steadily increasing numbers of short-staying guests. In the weeks following that holiday, overnight bookings increased sharply at motels and hotels. Patrons in restaurants once more were standing in line for service. And in many places proprietors of gift shops and other retail stores spoke of being impressed by their growing volume of business.

These pre-season visits necessarily were only two-day affairs because both Memorial Day and Fourth of July came at mid-week this year. Nevertheless, over several recent weekends a number of resort areas were reporting traffic congestion and a volume of business very nearly comparable to the three-day affairs which came in other years. Most bankers and businessmen seem to feel that the spending patterns of these short-staying vacationers are about in line with those of 1961 and former seasons noted for the excellent volume of their resort business.

### **Advance reservations show mixed trend**

Proprietors of hotels and motels in our leading mountain resorts report that they had more early inquiries this year and that advance reservations have shown a sizable increase over pre-season 1961. Given a good break on weather, the current season could be among the best in their experience. Demand for housekeeping cottages has been much more active than a year ago, with some places finding their listings nearly filled for July. Reports from both adult and children's camps in the Poconos are optimistic. Those operated for the "small fry" are looking toward capacity operations again this year.

Advance reservations are the weakest in shore-resort business as a whole. Vacationers have been looking over their old "stamping grounds" with what seems like an unusual amount of deliberation this year. In many places, early inquiries were about on a par with those in other years. But considerable hesitation has been in evidence when it came to making firm commitments in areas of the seashore not restored to their pre-storm status. Wherever reconstruction has been completed, landlords and realtors say that advance bookings are in good shape.

### **Rates a little higher in some places**

Although rate changes do not appear to have been pronounced anywhere in our vacationland, some "big name" places in the Poconos report small increases this season. In some cases they reflect higher operating costs, in others they are intended to help cover the expense of improved facilities. Most of the advances are said to affect hotel and motel rates.

A heavy demand over weekends seems to have prompted motels in some shore resorts to go to peak-season rates somewhat earlier than usual

this year. Increases in rates for other types of seashore accommodations have not been reported. Nor are reductions contemplated at this time, except possibly in the case of older guest houses the thought is expressed that concessions might be needed to compete successfully with what some of the newer facilities have to offer.

### **Length of stay a little shorter**

The long-term trend toward shorter reservation periods but more frequent visits continues very much in evidence this season. In recent years vacationers have demonstrated a preference to use their more liberal time allowance to go more places and cover more ground than was the custom a decade or so ago. The almost meteoric rise in motels has been one important factor; continuing improvement in highways leading to vacationlands has been another. And now a third reason why people lean toward a shorter stay is concern over weather.

Our seashore resorts in particular note the increasing reluctance of vacationers to take up residence for more than two weeks at a time. The terrific beating some of these places took from last winter's storm seems definitely to have played a part in decisions to make shorter stays this year. Hotels and motels have grown accustomed to one- or two-week reservation periods and they may not see too much difference this year. The real difference may be felt in the cottages, where reservation periods generally run from three weeks to a month or more.

### **Building activity accents repairs**

Several Pocono Mountain resorts can boast of

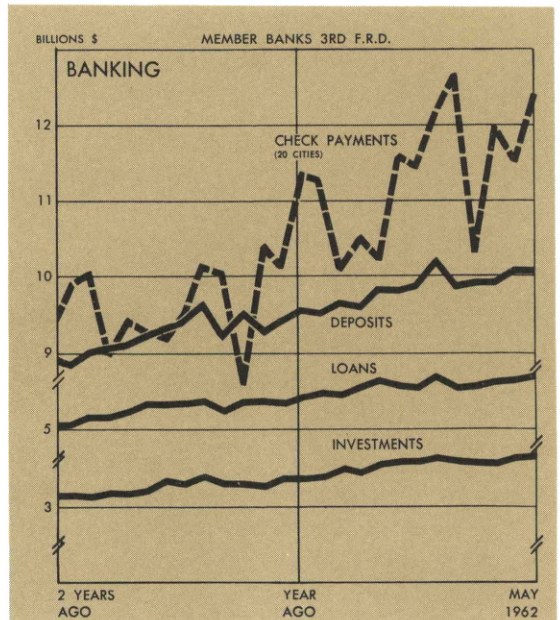
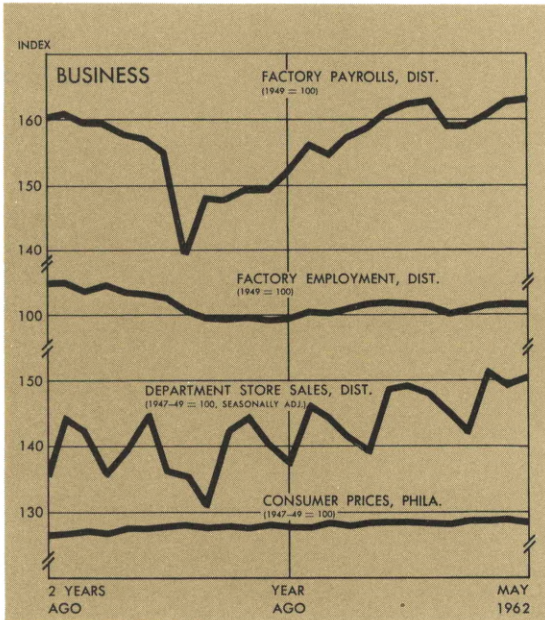
a few new or expanded motel facilities. Cottage construction in some places seems to have continued at a moderate pace. One of our larger seashore communities also added to its roster of motels, but cottage building in our whole shore resort area was of little consequence this year. Too many houses, both owner-occupied and for rent to vacationers, needed to be put back together or moved to new foundations after the storm. Repairs to torn-up boardwalks and shattered store fronts accounted for the balance of building activity in the heavily damaged coastal resorts.

### **1962 Resort business hard to predict**

It is hard to predict a full season's business on the basis of the pre-season performance of weekend vacationers. Even advance reservations don't always give too clear a picture. This year, largely because of the storm damage at shore resorts, it is especially difficult to make a reasonably accurate forecast at this time. Pocono Mountain resorts see an excellent July virtually assured. And several of our seashore vacation spots are looking at that month with a considerable degree of confidence.

Elsewhere along the coast a feeling persists that peak-season business is coming somewhat later than usual this year. As seen now, early July may be off somewhat from a year earlier. But businessmen in these seashore areas recovering more slowly from their storm damage expect vacation spending to pick up as the season progresses. They are counting on late-summer business to help make up for what appears to be a late start.

# FOR THE RECORD...



SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	May 1962 from		5 mos. 1962 from year ago	May 1962 from		5 mos. 1962 from year ago
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
<b>MANUFACTURING</b>						
Production.....	...	...	...	0	+ 9	+12
Electric power consumed.....	+ 3	+ 9	+13	...	...	...
Man-hours, total*.....	0	+ 4	+ 4	...	...	...
Employment, total.....	0	+ 2	+ 2	0	+ 4	+ 4
Wage income*.....	0	+ 8	+ 8	...	...	...
<b>CONSTRUCTION**</b>	+ 5	+16	+25	+ 4	+14	+17
<b>COAL PRODUCTION</b>	+ 1	+ 8	+14	- 1	+ 6	+12
<b>TRADE***</b>						
Department store sales.....	+ 1	+ 9	+ 6	+ 1	+11	+ 6
Department store stocks.....	+ 3	+ 8	...	+ 2	+ 7	...
<b>BANKING</b>						
(All member banks)						
Deposits.....	0	+ 5	+ 6	0	+ 7	+ 8
Loans.....	+ 1	+ 4	+ 4	+ 1	+ 8	+ 7
Investments.....	+ 1	+ 8	+ 9	0	+ 9	+10
U.S. Govt. securities.....	- 1	+ 9	+10	0	+ 4	+ 7
Other.....	+ 4	+ 7	+ 5	0	+22	+19
Check payments.....	+ 7†	+ 9†	+16†	+ 5	+10	+12
<b>PRICES</b>						
Wholesale.....	...	...	...	0	0	0
Consumer.....	0†	0†	+1‡	0	+ 1	+ 1

LOCAL CHANGES	Factory*				Department Store†				Check Payments	
	Employment		Payrolls		Sales		Stocks		Per cent change	
	Per cent change May 1962 from		Per cent change May 1962 from		Per cent change May 1962 from		Per cent change May 1962 from		Per cent change May 1962 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Lehigh Valley...	0	+ 6	+ 1	+15	...	...	...	...	+ 8	+15
Harrisburg.....	0	- 2	0	+ 1	...	...	...	...	+ 5	- 1
Lancaster.....	0	+ 4	- 1	+11	- 9	+14	+ 1	+ 2	+ 7	+ 6
Philadelphia....	0	+ 1	0	+ 6	+ 2	+10	+ 3	+10	+ 9	+ 8
Reading.....	0	+ 5	- 1	+12	- 2	+11	- 3	+12	+11	+ 6
Scranton.....	+ 1	+ 4	+ 1	+ 9	- 9	+ 2	+ 1	+ 4	+ 4	+ 4
Trenton.....	0	0	+ 3	+ 6	+ 9	+ 5	- 1	0	+ 3	+ 6
Wilkes-Barre...	0	+ 1	- 2	+11	- 4	+ 7	+ 1	+ 1	+ 6	+ 6
Wilmington.....	0	+ 2	0	+ 5	- 1	+ 6	- 1	+ 8	0	+32
York.....	0	0	+ 1	+ 3	- 4	+ 9	+ 1	+ 5	+10	+ 2

\*Production workers only.  
 \*\*Value of contracts.  
 \*\*\*Adjusted for seasonal variation.

‡20 Cities  
 †Philadelphia

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