MONTHLY REVIEW

Of Credit and Business Conditions

FEDERAL RESERVE BANK OF NEW YORK

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MONEY MARKET IN DECEMBER

Like its predecessors, the Victory Loan, the eighth and last of the series of Treasury drives to raise funds for financing the war, has surpassed its goal of 11 billion dollars by a wide margin. While the actual sales total is not yet available, it is expected that well over 20 billion dollars of new securities will prove to have been sold when the final tabulations are completed. This would make the total for the Victory Loan approximately the same as the Fifth and Sixth Loans and although considerably less than the total of 26 billion for the Seventh, it represents the heaviest oversubscription of the goal for any drive with the possible exception of the Seventh. It is yet too early for accurate determination of the amount of bank credit included in the drive totals but it appears that the expansion of bank credit in the Victory Loan was larger, relative to the smaller sales total, than in the Seventh drive.

As shown in the accompanying table, the Victory Loan promises to be the most expensive of any War Loan in terms of the interest cost to the Treasury on marketable issues sold to the investing public. Nonbank investors, apprehensive that long term interest rates might decline and apparently convinced that long term securities could be bought, even for short term holding, with equal safety and greater profitability than the shorter term obligations, subscribed heavily to the long term bonds offered in the drive. According to press reports, close to 10 billion dollars of 2½ per cent and 3 billion of 2¼ per cent bonds were sold in the Victory Loan drive—approximately 60 per cent of the total sales attributed to the drive. Thus, the average computed rate of interest on marketable issues sold to nonbank investors in the Victory Loan is estimated at 2.09 per cent, as compared with 1.95 per cent for the entire public debt outstanding at the end of November. As indicated in the table, the average interest rate on marketable securities declined in each of the first five loans from 1.84 per cent in the First drive to 1.60 in the Fifth, and then rose in successive drives to 1.92 per cent in the Seventh and 2.09 in the Victory Loan, the highest for all the drives, despite the downward drift, during the past year, in yields obtainable on outstanding Treasury securities purchased in the market.

Average Interest Cost to Treasury of Marketable Issues Sold to Nonbank Investors in War Loan Drives*

Drive	Average rate	Drive	Average rate
First	1.84%	*Fifth*	1.60%
Second	1.81	*Sixth*	1.70
Third	1.76	*Seventh*	1.92
Fourth	1.62	*Victory*	2.09*p*

* Excludes Treasury investment accounts.
p Preliminary.
Source: Federal Reserve Bank of New York.

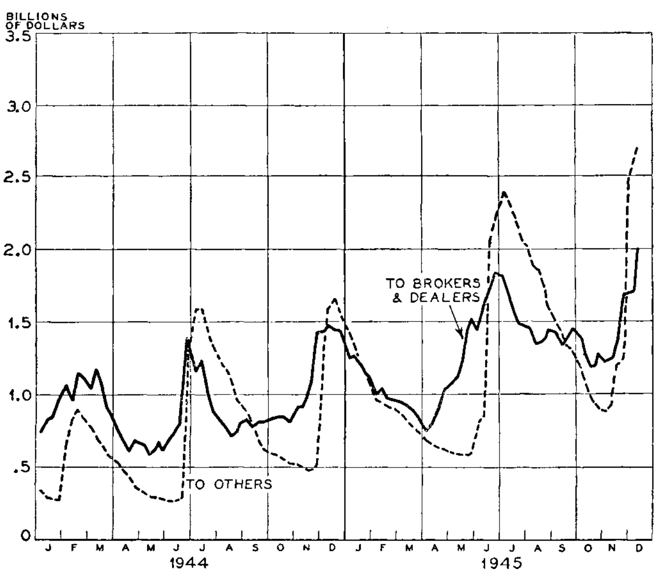
To the list of devices designed to minimize speculative subscriptions to drive offerings and to limit the expansion of bank credit in connection with the drives, there was added in the Victory Loan a restriction on War Loan accounts of the commercial banks to 30 per cent of all deposits (except War Loan deposits) held as of October 31, 1945. Despite this limitation on War Loan accounts, the banks made substantial purchases of outstanding Government securities during the drive, although the aggregate amount was smaller than in the Seventh campaign. In the seven statement weeks ended December 12, during which the books remained open for subscriptions to marketable issues, the increase in the Government security holdings (other than Treasury bills) of the weekly reporting member banks in 101 cities amounted to 2.6 billion dollars, as compared with 3.2 billion in the seven weeks ended June 27 in the Seventh drive. Federal Reserve Bank net purchases of Government obligations other than Treasury bills came to about a billion dollars in the current drive against 1.2 billion in the preceding one.

Loans on Government securities of the weekly reporting member banks, on the other hand, increased more rapidly in the Victory Loan than in the Seventh drive, reflecting chiefly the heavy subscriptions for the 2½ per cent bonds. Total Government security loans increased 2.6 billion dollars in the seven weeks ended December 12, as against 2.3 billion in the corresponding period of the Seventh drive. The increased expansion came largely among the banks in 100 cities outside New York where the rise in loans to borrowers other than brokers and dealers was 250 million dollars greater than in the preceding drive, while the increase in loans to brokers and dealers was about 50 million dollars less. The reverse occurred among New York City banks where loans to brokers and dealers rose 705 million dollars in the seven weeks ended December 12 compared with 565 in the comparable Seventh drive period, while loans to others rose about 830 million compared with 925 in the last War Loan reflecting smaller borrowings of insurance companies during the current drive. Purchases of Government bonds by the insurance companies on the deferred payment plan, however, were much more extensive this time and may presage some expansion in insurance company borrowings before the final payments on such purchases are due.

As shown in the accompanying chart, Government security loans have risen steadily in the last four drives; new high points have been scored in each, and the subsequent interdrive liquidation has failed to eliminate all of the preceding expansion so that each between-drive low point has been higher than the previous one. On December 12, total loans on Government securities of all weekly reporting member banks reached a new peak of 4.7 billion, an amount 500 million above the previous record. In the week ended December 19, limited amounts of Government security loans were liquidated as some subscribers were quick to take advantage of a strong market for the long term bonds, which sold at premiums of one point or more shortly after trading in the drive securities got under way.

For the entire banking system including the Federal Reserve Banks, it may be estimated that the expansion of Government security holdings and loans on Government obligations amounted to roughly 10 billion dollars in the Victory Loan. That is slightly less than the amount in the Seventh drive, but represents a considerably higher percentage of the total sales during the drive.

Loans for Purchasing or Carrying U. S. Government Securities by Weekly Reporting Member Banks in 101 Cities



Member Bank Reserve Positions

Member bank reserve positions were not eased as much during the Victory Loan drive as might have been expected. Reserve requirements fell about 300 million dollars in the seven weeks ended December 12, compared with 670 million in the corresponding period of the Seventh War Loan drive. The factors chiefly responsible were the smaller net absorption of securities by nonbank subscribers in the current drive and the extensive use by such investors of funds received from the cash redemption by the Treasury of maturing certificates and other securities (amounting to about 1.6 billion dollars) to acquire new issues offered in the drive.

In fact, the major factor in the easing of the member bank reserve position in the week ended December 5, which included the payment date for corporation subscriptions to Victory Loan issues, was a heavy excess of Government expenditures over receipts in connection with public debt redemptions. These expenditures were sufficient not only to eliminate most of the Treasury's balance with the Reserve Banks, which amounted to 557 million in the preceding week, but also to make it necessary for the Treasury to borrow temporarily from the Reserve Banks through the sale to them of special certificates of indebtedness, the amount of which totaled 318 million dollars on December 5 and reached a peak of 484 million on December 7 and 8. Member banks receiving these funds were able to retire a substantial amount of Reserve Bank credit—through repayment of borrowings and repurchases of Treasury bills—and to expand their excess reserves. At the same time, however, the Reserve Banks found it necessary to absorb considerable amounts of other short term Government securities offered for sale by nonbank investors or by banks in need of reserves, because of insufficient demand from other sources to absorb the supply.

In order to avoid sudden heavy drains on the reserves of banks whose corporation customers subscribed for Victory Loan securities in such volume that the payments could not all be credited to War Loan accounts within the 30 per cent limit previously referred to, the banks were permitted temporarily to credit all payments for subscriptions to War Loan accounts, even though they exceeded that limit. The banks were then instructed to pay the "overages" to the Federal Reserve Banks for account of the Treasury in five equal instalments on December 10 to 14, inclusive. These payments were made in such volume (over 400 million dollars a day) that the banks were permitted to defer the last two instalments from December 13 and 14 to December 15 and 17. These payments, together with collections of corporation income and excess profits taxes for the fourth quarter, so greatly exceeded Government disbursements in the two weeks ended December 19 that the Treasury was able to repay its temporary borrowings from the Reserve Banks and to accumulate balances of 718 million dollars in the Reserve Banks. In these circumstances, member bank needs for Federal Reserve Bank credit again increased and excess reserves were reduced.

Seasonal demands for currency also absorbed substantial amounts of reserve funds in the three weeks before Christmas, and are estimated to have raised the amount of money in circulation in the month of December by about 450 million dollars, exceeding the increase for the corresponding month of 1944 (288 million) for the first time since August. To a large extent the greater increase this December probably reflects the unprecedented volume of holiday trade. A minor factor may have been the smaller sales of Series E bonds (many of which are paid for in cash) in the Victory Loan than in the Sixth War Loan.

Owing to the usual transfer of funds out of New York City during drives, related to payments for Government securities sold in the New York market by out-of-town investors to obtain funds for investment in the new issues, and to withdrawal of funds from New York during tax periods to cover payment of corporation taxes in other localities, banks outside New York City were able to retire Reserve credit or expand their Treasury bill holdings to a greater extent, relatively, than the New York City institutions. Weekly reporting member banks in other parts of the country acquired 617 million dollars of bills in the seven weeks ended December 12 compared with 372 million in the Seventh drive.

LONG TERM INTEREST RATES AND STOCK YIELDS DURING THE WAR

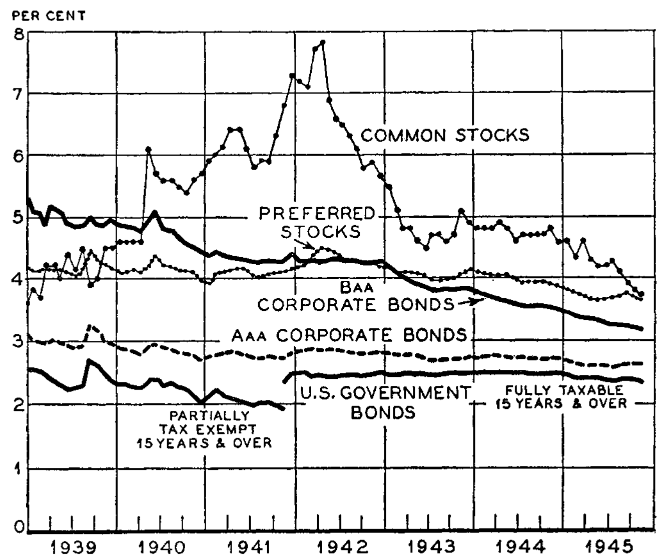
During the war period we have experienced a decline in long term interest rates to lower levels than ever before in the face of huge demands for funds from the Treasury, first to finance a rapidly expanding national defense program, and then to finance a war program of a magnitude far beyond anything previously imagined. The explanation lies primarily in heavy bank buying of Government securities, which not only provided a persistent demand for such securities, but at the same time resulted in a great expansion in the money supply in the hands of the public.

The decline in long term interest rates had been in progress for some years prior to the war and its continuation during the early years of the war reflected the large-scale inflow of gold from abroad, which not only provided the basis for a substantial expansion of bank credit, but also resulted in a heavy accumulation of idle funds in the banks. Since early in 1942 the great expansion in bank credit, the accompanying growth in the money supply in the form of bank deposits and currency, and the continued low interest rates have been made possible chiefly by an expansion of Federal Reserve credit which has lifted the total loans and investments of the Federal Reserve Banks from less than 2½ billion dollars to nearly 25 billion. While the Federal Reserve System has endeavored to limit its extensions of credit to the amounts required to assure the availability to the Government of adequate funds to finance the war effort at stable interest rates, the huge growth in the money supply and the efforts of individuals and investing institutions to employ profitably the growing volume of funds at their disposal has had far-reaching effects on the market for various classes of long term investments.

The pressure of funds seeking investment, together with the improved financial position of business concerns during the war period and a growing optimism regarding business prospects, has been reflected in a narrowing of the spread between yields on investments involving varying degrees of risk to the point where the over-all spread between yields on the various classes of securities has become less wide than at any previous time for which adequate records are available (since 1919). In November, as indicated in the accompanying chart, the spread between fully taxable long term Treasury bonds and the average yield on a list of 200 common stocks was only 1.4 per cent.

Comparisons between yields on long term Government securities and yields on the highest grade corporation bonds were confused during most of the period prior to the latter part of 1941 by the tax exemption features of Government bonds. It is clear, however, that the spread between yields on these two classes of securities had been narrowing for several years prior to the war, and that some further narrowing has occurred since 1941. In the intervening period (1939 to 1941), the spread between yields on long term partially tax-exempt Treasury securities and on long term high grade corporation bonds widened somewhat, reflecting higher taxes and the consequent increase in the value to investors of the partial exemption of income from Treasury securities. Allowing roughly for the

Yields on Long Term Bonds and Stocks



Source: U. S. Government bonds, Treasury Department; 15 high grade noncallable preferred stocks, Standard & Poor's Corporation; 20 Aaa corporate bonds, 30 Baa corporate bonds, and 200 common stocks, Moody's Investors Service.

value of tax exemption features, the spread between yields on Government and high grade corporation bonds undoubtedly is now considerably narrower than in years prior to 1932. During the 20's the relatively wide spread was attributable, at least in part, to the retirement of public debt and the consequent limitation of the supply of Government securities, while the supply of high grade corporate bonds was relatively ample. The narrowing of the spread since 1932 is probably explained in large measure by a reversal of that situation—an increasing supply of Government securities and a limited supply of high grade corporation bonds.

The rapid narrowing of the spread between yields on medium grade corporate obligations (Baa bonds) and Treasury and highest grade corporate bonds during the war period apparently reflects the combined effect of improved conditions and prospects for business, including the strengthened financial position of many business concerns during the war, and of the efforts of individual investors and investing institutions to obtain higher yields than are obtainable from investments in the highest grade securities. As a result of these factors, the average yield obtainable from a representative list of Baa bonds receded from close to 5 per cent in December 1939 to 3.2 per cent in November 1945. Railroad bonds of this grade had an especially strong rise in price (and decline in yield), reflecting the notable expansion in railroad traffic and earning power during the war which permitted heavy purchases by the railroads of their outstanding obligations for retirement, as well as attracting other investment demand. Toward the end of 1945, the spread between yields on medium grade and the highest grade corporate bonds had become the narrowest since at least 1918—the period for which records are available. In November of this year Baa bonds were selling at yields equivalent to those obtainable from Aaa bonds toward the close of 1939.

On the other hand, yields obtainable from a selected list of high grade, noncallable corporation preferred stocks have moved roughly parallel to yields on the highest grade corporate bonds, and in the period from the end of 1939 to November 1945 declined only from 4.1 per cent to 3.6 per cent. At the end of this period the yield on high grade preferred stocks was nearly ½ per cent higher than on medium grade bonds, whereas at the end of 1939 it was approximately 0.8 per cent lower. The relative lag in the movement of preferred stock yields may be attributable at least in part to the fact that institutional demand for such stocks is limited by legal restrictions on the investments permissible for commercial banks, savings banks, and life insurance companies. In part, it may also reflect some continuing uncertainty on the part of investors as to the future of interest rates; prices of noncallable preferred stocks are greatly affected by changes in the general level of interest rates, since these securities have no maturity date as have bonds, and thus are little affected by considerations other than the investor's appraisal of the prospect for long term interest rates and of the safety of the investment. Many preferred stocks of this class were issued a number of years ago and are now selling at prices far above their par value. Where preferred shares are subject to call, the wartime rise in prices has been limited by the call prices.

Yields obtainable from investments in common stocks have fluctuated widely during the war years, reflecting the combined effect of changes in prices and in dividend payments. Prices of equity securities reflect primarily the investing public's appraisal of business conditions and prospects, but even these securities are not entirely unaffected by the general levels of interest rates. As the accompanying chart indicates, the average yield of a list of 200 common stocks rose from between 3.6 and 4.5 per cent in 1939 to a peak of 7.8 per cent in April 1942, and then fell to 3.7 per cent in 1945. Increased dividend payments were a minor factor in the rise in common stock yields from 1939 to the spring of 1942, but the major factor was the influence of adverse developments in the war during that period. Similarly, the rapid fall in common stock yields from the spring of 1942 to the summer of 1943 reflected primarily the improvement in war prospects, although the high level of business activity and the strengthened financial position of business organizations undoubtedly contributed to the rise in stock prices and the decline in their yields. The subsequent further decline in yields on equity securities apparently reflects public optimism concerning the prospects for business, with its speculative accompaniments, and the efforts of investors to find more profitable employment for their funds than is possible through investments in high grade bonds. Despite the strong rise in common stock prices since the spring of 1942, yields obtainable on such securities remain higher than in several earlier periods of public optimism with respect to investments in equity securities. They are still considerably above the yields obtainable on highest grade or even medium grade corporation bonds, whereas prior to the war they were usually well below the yields obtainable on medium grade bonds, and at times fell well below the yields obtainable from investments in the highest grade corporation bonds.

ANGLO-AMERICAN FINANCIAL AGREEMENT

After nearly three months of detailed negotiations in Washington, a financial agreement between the American and British Governments has been signed, with mutual concurrence reached on all major points included in the agenda. The agreement has already been approved by the British Parliament and will become effective when ratified by Congress.

The documents issued by the two governments include a financial agreement, a joint statement regarding the settlement of lend-lease, reciprocal aid, surplus war property and certain other claims, and a joint statement regarding understandings reached on commercial policy.

The statement covering lend-lease and other wartime claims provides for a final and definitive settlement, amounting to a virtual cancellation, of British lend-lease obligations to the United States. It specifies that the net sum to be due the United States from Britain for "the settlement of Lend-Lease and Reciprocal Aid, for the acquisition of surplus property, and the United States interest in installations, located in the United Kingdom, and for the settlement of claims shall be $650,000,000," subject to a possible adjustment noted below. This amount consists of: (a) 118 million dollars, representing the excess of lend-lease goods and services furnished to Britain from V-J Day to December 31, 1945 over reciprocal aid extended by Britain to the United States during the same period, *less* the net sum due to the United Kingdom under the claims settlement; and (b) 532 million dollars, the sum agreed upon for the settlement of all other lend-lease and reciprocal aid items and for British acquisition of American surplus property, and of American interest in installations, located in the United Kingdom. The sum of 118 million dollars mentioned above is subject to adjustment in the light of subsequent accounting and the total of 650 million dollars will then be adjusted accordingly. The resulting net liability will be discharged on the same terms as those specified in regard to the dollar line of credit referred to below. A variety of supplementary technical provisions are included to protect American interests in connection with the disposal by the British of the surplus property, lend-lease articles and installations referred to.

The financial agreement proper provides for the extension of a line of credit amounting to 3,750 million dollars (over and above the 650 million dollars already mentioned), which may be drawn upon at any time between the effective date of agreement (the date on which the United States Government notifies the British Government that Congress has made available the funds necessary to extend the line of credit to Britain) and December 31, 1951, inclusive. The terms and conditions of the line of credit, the main purpose of which is to assist Britain over her transitional balance of payments difficulties, may be summarized as follows:

(1) The amount drawn will be repaid in 50 equal annual installments of principal and interest combined, commencing December 31, 1951, with interest at the rate of 2 per cent per annum calculated on the amount outstanding on December 31, 1951, and on January 1 of each year thereafter. The annual installments will amount to 31.8 million dollars for each billion dollars of credit utilized.

(2) If the International Monetary Fund certifies in any year that average annual British receipts from merchandise exports and net current "invisible" exports over the preceding five years are less than (a) the average annual value of British imports in 1936-38, adjusted for price changes, plus (b) a sum up to 43,750,000 pounds if used to repay or release sterling balances accumulated before the effective date of the agreement, Britain may request and obtain a waiver of the interest payment (but not the principal repayment) due in that year. The purpose of this provision is to introduce an element of flexibility into the total annual loan payments so as to ease the pressure on Britain in difficult years.

(3) Any loans which Britain receives from governments within the British Commonwealth between December 6, 1945 and December 31, 1951, must be on terms no more favorable to the lender than those contained in the American agreement.

(4) A waiver of interest will not be allowed in any year unless the aggregate repayments in that year of foreign sterling balances accumulated before the effective date of the agreement are "reduced proportionately," and unless interest payments are similarly waived on the above-mentioned loans from British Commonwealth governments.

Probably the most interesting features of the agreement are the commitments imposed upon Britain in return for the line of credit. The British Government agrees at the earliest possible time, no later than one year after the effective date of the agreement, to permit, with a few exceptions, free convertibility of sterling accruing to sterling area countries from current transactions (as defined by the International Fund Agreement) and similarly to permit these countries to dispose freely of any dollars which they are currently acquiring. It likewise agrees that after the effective date of this agreement, and up to December 31, 1951, it will not apply exchange controls in such a manner as to restrict, "(a) payments or transfers in respect of products of the United States permitted to be imported into the United Kingdom or other current transactions between the two countries, or (b) the use of sterling balances to the credit of residents of the United States arising out of current transactions." Here a special clause is inserted stating that the "scarce currency" provisions of the Bretton Woods Fund agreement shall not be affected by these arrangements.

Extending these clauses to include all countries, the two governments agree that beginning one year (or sooner) after the effective date of the agreement, and at least until December 31, 1951, they will impose no restrictions on payments or transfers for current transactions in *general*. Here exception is made for convertibility of balances of third countries accumulated before this provision comes into force, for restrictions imposed under the International Fund Agreement (with the transitional period provisions exempted, however), and for restrictions imposed in connection with the uncovering and disposal of German and Japanese assets.

The agreement also provides that if either of the two governments should impose or maintain quantitative import restrictions, such restrictions shall not be administered on a basis which discriminates against imports from the other country. This commitment, which is subject to certain qualifications, is to become effective no later than December 31, 1946.

With regard to accumulated sterling balances, the British Government agrees to make an early settlement with the various creditors, varying according to the circumstances of each case. These balances will be divided into the following three categories: "(a) balances to be released at once and convertible into any currency for current transactions, (b) balances to be similarly released by installments over a period of years beginning in 1951, and (c) balances to be adjusted as a contribution to the settlement of war and postwar indebtedness and in recognition of the benefits which the countries concerned might be expected to gain from such a settlement." It is further specified that balances released in any one of the above-mentioned ways will be "freely available for current transactions in any currency area without discrimination."

The Anglo-American financial agreement constitutes an important step forward in the broad program of the United Nations designed to restore a multilateral world trading system. The line of credit extended to Britain will help that country to meet its global balance of payments deficit (estimated in a recent British White Paper at an aggregate of 5 billion dollars in 1946-48) during a period when it will be struggling to restore its export position, and removes the dangerous possibility of Britain being forced to continue or even intensify its present restrictive and discriminatory trade and exchange policies. The British, indeed, have agreed, with the few exceptions noted above, to restore within a year multilateral convertibility of sterling, to avoid using import licensing in a discriminatory way, and to make plans for an early settlement of its huge accumulated sterling balances (estimated at about 14 billion dollars). In the longer run, however, the solution to the pressing British balance of payments problem, and thus the basis for a removal of that country's restrictive trade policies, must lie in a very great expansion of its exports relative to imports. The achievement of this objective will depend not only upon Britain's ability to adapt the character of its exports to the altered requirements of the world market and to raise the productivity of its industry well above present levels, but also upon the existence of high levels of income throughout the world (to which the United States can make an important contribution), the resumption of large-scale long term international lending in general and a substantial reduction of tariffs and other barriers to trade.

THE PROPOSED INTERNATIONAL TRADE ORGANIZATION

In connection with the Anglo-American negotiations, and as explained in the joint statement on commercial policy issued at the end of the negotiations, the United States Government has set forth a proposal for an International Trade Organization, that will take its place beside the international institutions established in the fields of relief and rehabilitation, currency, foreign investment, food and agriculture, and civil aviation. The plan for the trade body, as part of a State Department document which is set forth in "Proposals for Expansion of World Trade and Employment," has been submitted to other governments for their consideration, preparatory to a conference on International Trade and Employment to be held not later than the summer of 1946. The joint statement on commercial policy prepared by the American and British negotiators states that these Proposals have the endorsement of the executive branch of the United States Government and that the British Government is in full agreement on all important points and accepts them as a basis for international discussion. The joint statement also reports agreement by the two countries on procedures for the international negotiation and implementation of the Proposals. It is understood that these negotiations will be of two kinds: (1) "nuclear" trade agreements made under the recently extended and broadened authority of the Reciprocal Trade Agreements Act, into which the United States will enter with Britain and other leading countries; and (2) a preparatory conference next spring of the United States and fourteen other countries, representing diverse types of foreign trading systems, in order to elaborate upon the draft Articles of Agreement of the Organization.

The general Proposals contain two preliminary parts, the first one pointing to the need for international economic cooperation, and the second setting forth the aims and governing principles to guide member States in their employment policies. It is urged that countries exchange information and consult regularly on their employment problems and that each take action designed to achieve full employment within its own jurisdiction and in ways appropriate to its political and economic institutions. Governments are also asked to pledge themselves not "to maintain employment through measures which are likely to create unemployment in other countries or which are incompatible with international undertakings designed to promote an expanding volume of international trade and investment in accordance with comparative efficiencies of production." The third part of the Proposals contains the actual draft terms of the Internatinal Trade Organization. Apart from organizational details, these fall into three main chapters: General Commercial Policy; Restrictive Business Practices; and Intergovernmental Commodity Arrangements. The main separate sections in the first named chapter, the core of the draft document, are on tariffs and preferences; quantitative trade restrictions; subsidies; and State trading.

Acknowledging the guidance of Article VII of the Mutual Aid Agreements, the section on tariffs and preferences requires member States to arrange for "the substantial reduction of tariffs" concurrent with "the elimination of tariff preferences." The implementation of this section by the United States and Great Britain, for example, would result in the reduction of American tariffs, which the President is now empowered to effect up to 50 per cent of duty rates prevailing on January 1, 1945, and the elimination of the British imperial preference system set up at the Ottawa Conference in 1932. However, there is a qualifying clause to the effect that a country reducing its tariff may "take temporary action to prevent sudden and widespread injury to the producers concerned. Undertakings for reducing tariffs should therefore contain an escape clause to cover such contingencies."

The draft document recommends a general prohibition of quotas, embargoes, and other quantitative restrictions on import and export trade, save for certain important exceptions, notably two: (1) in regard to import quotas on agricultural products (imported in any form) that are required for the enforcement of government measures of domestic marketing of the same or like products; and (2) in cases of countries having an adverse balance of payments. Import quotas in force for either of these reasons should operate in nondiscriminatory fashion, that is, in the light of the import pattern of "a representative period" and of "any special factors" affecting trade in the products concerned, but not inequitably distinguishing among sources of supply.

The International Trade Organization would require that it be kept informed of all subsidies affecting international trade, including domestic subsidies granted in lieu of tariff protection on articles produced at home and export subsidies lowering the prices of articles entering world markets. But only export subsidies are expressly disapproved in the proposed draft, so that it is not impossible, so far as the influence of the Organization is concerned, that domestic subsidies might be more commonly adopted than in the past as a substitute for tariff protection. A maximum of three years from the date of establishment of the Organization is allowed before the recommended prohibition against export subsidies must be made effective, although for individual commodities an extension may be granted a member by the Organization. A commodity which is in burdensome world surplus is exempted from the prohibition in case international cooperation (along the lines of raising world consumption and reallocating productive resources) fails to bring about a satisfactory supply-demand balance "within a reasonable time."

The paragraphs on State trading cover two categories of foreign trade operation: complete government monopoly, as in the Soviet Union, and State monopoly companies dealing in individual commodities (salt, tobacco, and others), such as exist in many countries. It is stipulated that all State trading bodies should make their purchases and sales in a nondiscriminatory fashion and according to commercial considerations alone, taking into account "price, quality, marketability, transportation and terms of purchase or sale." Under this provision, the imports of any country (e.g. the Soviet Union) having a State monopoly of foreign trade would be made under a so-called global purchase arrangement, under which it would announce its aggregate imports for a year and would purportedly be required to refrain from pressing for unduly favorable terms from one country as against another through the threat of shifting its purchases.

The chapter on restrictive business practices contains a general pronouncement against cartel operations in international trade, which are defined as "combinations or agreements to fix prices and terms of sale, divide markets or territories, limit producton or exports, suppress technology or invention, exclude enterprises from particular fields, or boycott or discriminate against particular firms." Apart from encouraging member States to eliminate such practices within their own jurisdiction, and to cooperate with one another toward this end, the Organization assumes responsibility for: (1) receiving complaints both from member States against a cartel, and from private business firms if their governments permit; (2) asking members for information concerning such complaints; (3) recommending appropriate action by members; (4) requesting reports from members as to the progress of their implementation of such recommendations; and (5) conducting studies, making recommendations concerning uniform national standards, and calling consultative conferences.

An important feature in the chapter on intergovernmental commodity arrangements is the provision that any such arrangement be limited to a period during which the chronic surplus condition of particular primary commodities would be relieved by fundamental economic adjustments "designed to promote a shift of resources and manpower out of overexpanded industries into new and productive occupations." For this purpose, the Organization would establish limited-life commodity pacts providing for a limitation of production and an allocation of markets. These pacts would be formed (with full publicity) for a period of no more than five years, subject to renewal if circumstances warrant. Nations interested primarily in the consumption of the particular commodity would have equal voting power in the agreements with producing nations interested in export markets.

It is finally stated in the draft Proposals that the International Trade Organization will come within the scope of the coordinating authority of the Economic and Social Council of the United Nations Organization. Coordination of the Organization with other specialized economic agencies, particularly the International Monetary Fund, as in joint endeavors to have member States outlaw undesirable trade and exchange practices, is an essential requirement for its success. Another essential requirement, the importance of which is underscored by the long series of failures in commercial policy reform in the interwar years, is a sincere effort by member States to implement the trade body's recommendations. Political stability and secure cooperation among nations are also essential desiderata if the proposed Organization's objective of an expanding, multilateral world trade is to be achieved.

CURRENCY REFORM IN THE NETHERLANDS

In liberated Europe one country after another has been carrying out the basic changes in its currency system which have been necessitated by the ending of enemy rule. In this article the Dutch "currency purge," as the recent currency reform in the Netherlands has been officially called, will be described against the background of the French and Belgian policies which were surveyed in the October 1945 issue of this *Review.*

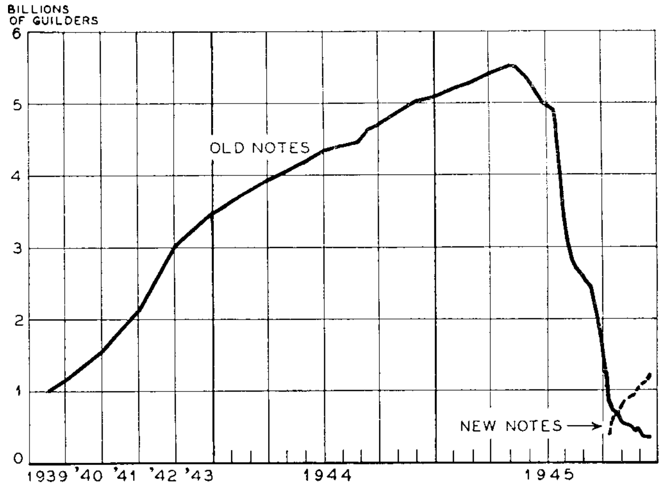
As in Belgium and France, the object of the measures enacted in Holland was to obtain a census of liquid assets, to cancel notes acquired through illicit means, to prevent reinfiltration of enemy-held notes, to put a brake on black market activities and tax evasion, and, above all, to curtail the amount of notes in circulation. Unlike the French measures, which entailed no blocking whatever, the Dutch currency measures were characterized by drastic blocking on the Belgian pattern.

The "currency purge" was not technically effected in a single stroke, as in France and Belgium, but in two separate moves. Between July 9 and 14 all 100-guilder notes (the largest denomination still circulating) were deprived of their legal tender attribute, and between September 26 and October 3 the notes of all other denominations lost their validity as legal tender. The procedure adopted for the withdrawal of the 100-guilder notes was simple. They were declared invalid and had to be deposited with commercial and agricultural banks in interest-free accounts which were blocked "for a time," except for the payment of taxes.

The second part of the currency reform was announced on September 12. The fact that it was thus made public two weeks before it was put in effect is in itself a distinctive feature of the Dutch currency plan. In Belgium and in France, the withdrawal of old currency began immediately after the announcement was made; and in Belgium, the exchange of old for new notes had to be completed within five days.

Another distinctive feature of the Dutch "currency purge" is that it avoided, even for a short period, the simultaneous circulation of old and new currencies. The experience of Belgium and France had taught the Dutch that such simultaneous circulation was highly undesirable because it enabled black market dealers to exchange "tainted" old currency for the new notes. Accordingly, a procedure was devised in Holland under which, during the final withdrawal of old notes, all payments were deferred with the exception of day-to-day subsistence expenditures. The timing of the successive phases of the currency reform was roughly as follows: In the week of September 19-25, immediately preceding the date on which the old currency was to cease to be legal tender, the Dutch population (except business enterprises) was requested to deposit with banks all cash exceeding 300 guilders per household; simultaneously, each household head was given the opportunity to exchange, for each member of the household, 10

Note Circulation of the Nederlandsche Bank



guilders into the new currency to be used during the following week for current expenditures. On September 26 all of the old paper money still in circulation (i.e., up to 300 guilders per household and the notes held by business enterprises) lost its validity as legal tender and had to be deposited with the banks by October 3; and all balances with banks, savings banks, public clearing institutions, etc., were blocked. Beginning October 4 new notes were put in circulation and the blocked accounts were partially released.

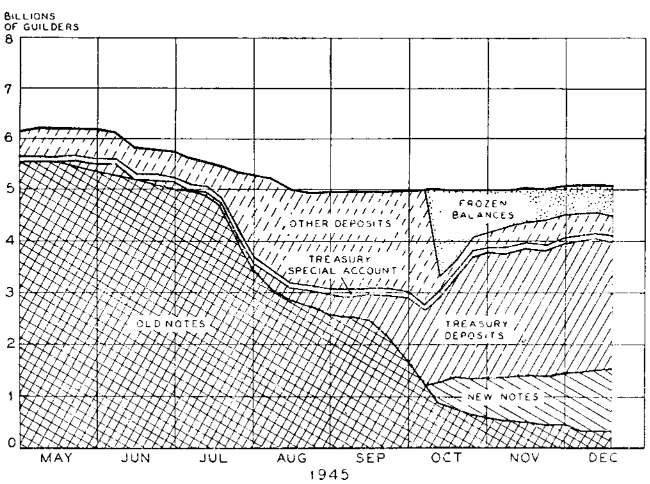
The deblocking process in Holland, in comparison with the Belgian precedent, was both stricter and more flexible. This is a third distinctive feature of the Dutch "currency purge." In principle, the new currency was made available only to the extent that it was required for uses compatible with the over-all national economic policies: (1) Funds necessary for the payment of wages, salaries, pensions, interest, and other periodical disbursements were freed immediately. In this way, a flow of new notes was brought into circulation, and it was expected that business enterprises, out of sales proceeds, would soon have sufficient means to pay wages, salaries, etc., without further deblocking. As this expectation was realized, the amounts permitted to be deblocked from week to week were gradually reduced. (2) To replenish the cash holdings of households, 100 guilders were released to each household in cash on October 4; in addition, the bank balances of each household were unblocked to the extent of 1,000 guilders plus 25 per cent of the balance as of September 12 (with an over-all limit of 10,000 guilders) for use exclusively in transfers from one account to another. (3) New currency was made available to business enterprises to the extent required for permissible purchases of raw materials and equipment. (4) Exemptions were provided for cases of individual hardship. Unblocked funds could be used only for the payment of taxes (including a proposed capital levy), for subscription to government loans, and for conversion into savings deposits at savings and commercial banks.

As a result of these measures, the note circulation was sharply contracted, as shown in the accompanying diagram. Between May 15, when (immediately after liberation) it reached the all-time peak of 5,507 million guilders, and September 10 (immediately prior to the announcement of the exchange of notes), note circulation was reduced by 3,062 million guilders. Of this reduction, some 1,332 million guilders were accounted for by the withdrawal of the 100-guilder notes. Between September 10 and October 1 the note circulation declined further by 1,284 million guilders. Since October 8 the circulation has been carried in the Nederlandsche Bank's published statements in two accounts, old currency and new currency (335 million and 1,220 million guilders, respectively, on December 17).

The deposit of hoarded currency with the banks enabled them to purchase large amounts of Treasury bills. With the funds thus obtained, the Treasury was able to redeem, within ten weeks after the liberation, all of the Treasury bills which it had placed directly with the Nederlandsche Bank, and which, on May 14, 1945, had amounted to 789 million guilders. Moreover, the withdrawal of notes from circulation and hoards resulted in an expansion of government and private deposits with the Nederlandsche Bank. The progress of the week-by-week absorption of currency can be seen in the second diagram. The Treasury, which had no deposits with the Nederlandsche Bank prior to the liberation, accumulated a substantial balance amounting to 12,417 million guilders on December 17. The "other" deposits, which, since July 16, had included the 100-guilder notes withdrawn from circulation, reached 2,245 million guilders on October 1; beginning October 8, the notes surrendered were excluded from "other" deposits and shown separately as "frozen balances." As the diagram shows, these "frozen balances" were reduced from 1,708 million guilders on October 8 to 564 million guilders on December 17; this reduction was almost balanced by an increase in the government deposits during this same period, which suggests that blocked balances have been used by the owners either to pay taxes or to purchase Treasury bills.

Through the "currency purge" and the accompanying fiscal and other measures, Holland fulfilled some of the conditions essential to her economic and financial rehabilitation. The volume of money in circulation, including the unblocked demand deposits available for current payments, was brought to around 2.5 billion guilders—a level at which it is expected to remain stabilized for the time being. Since the national income is now officially estimated at some 5 billion guilders, the relation between the supply of money and the national income appears to have been restored to a level comparable to that prevailing in the United States and the United Kingdom. As the national income slowly rises, the government is reported to intend increasing the note circulation correspondingly, maintaining a close parallel between income and circulation.

Demand Liabilities of the Nederlandsche Bank



Indexes of Business

Index	1944	1945		
	Nov.	Sept.	Oct.	Nov.
Industrial production*, 1935-39 = 100 (*Board of Governors, Federal Reserve System*)	232	169*r*	163*r*	171*p*
Electric power output*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	200	185*r*	180*p*	
Ton-miles of railway freight*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	215	193	169*p*	
Sales of all retail stores*, 1935-39 = 100 (*Department of Commerce*)	192	190	202*p*	
Factory employment				
United States, 1939 = 100 (*Bureau of Labor Statistics*)	163	123	122	122*p*
New York State, 1935-39 = 100 (*New York State Dept. of Labor*)	145	117	116*p*	
Factory payrolls				
United States, 1939 = 100 (*Bureau of Labor Statistics*)	332	216	214*p*	
New York State, 1935-39 = 100 (*New York State Dept. of Labor*)	286	215	217*p*	
Income payments*, 1935-39 = 100 (*Department of Commerce*)	238	229*r*	232*p*	
Wage rates, 1926 = 100 (*Federal Reserve Bank of New York*)	167	167	167*p*	
Consumers' prices, 1935-39 = 100 (*Bureau of Labor Statistics*)	127	129	129*p*	
Velocity of demand deposits*, 1935-39 = 100 (*Federal Reserve Bank of New York*)				
New York City	76	82	84	82
Outside New York City	76	71	68	73

* Adjusted for seasonal variation. *p* Preliminary. *r* Revised.

DEPARTMENT STORE TRADE

Christmas buying surpassed all previous expectations, and the dollar volume of department store sales in this District exceeded last year's record by approximately 15 per cent. Many items which normally account for a large proportion of the holiday purchases were either absent from the shelves or not available in sufficient quantities to meet the consumers' demand. Nevertheless the shoppers filled their Christmas lists with the merchandise at hand. Trade sources indicate that gift buying was concentrated in the higher priced lines, and the actual number of Christmas purchases did not vary appreciably from that of a year ago.

Among the individual departments, hosiery and lingerie normally experience a heavy Christmas demand. Stocks of these items were exceptionally thin this year, and many shoppers solved the gift problem with purchases of neckwear, blouses, handkerchiefs, gloves, handbags, jewelry, and toilet articles. Some houseware items reappeared on the market in time for Christmas shopping, and gift buying was exceptionally heavy in these departments. Men's furnishings, also a department which normally receives a large share of the holiday trade, experienced an exceptionally large sales increase in spite of the absence of many desired items. Consumer demand for both men's and women's ready-to-wear was very heavy.

The dollar volume of merchandise sold by Second District department stores is estimated to have exceeded 100 million dollars in November and 135 million dollars in December. Purchases in these two months surpassed the corresponding 1939 volume by 70 per cent. Department store sales for the year 1945 approximated 915 million dollars, an increase of 13 per cent over 1944 and of about 70 per cent over 1939. Many merchants have expressed their belief that 1946 will be a prosperous year in retailing. A large part of the stocks of war substitute merchandise has been cleared from the shelves and many items in the durable consumer goods field are coming through in substantial quantities. The pent-up demand for this merchandise will add substantially to the 1946 sales volume.

Department and Apparel Store Sales and Stocks, Second Federal Reserve District, Percentage Change from the Preceding Year

Locality	Net sales		Stocks on hand
	Nov. 1945	Jan. through Nov. 1945	Nov. 30, 1945
Department stores, Second District....	+14	+13	+ 4
New York City	+17	+14	+ 4
Northern New Jersey	+12	+13	+ 5
Newark	+11	+14	+ 6
Westchester and Fairfield Counties	+ 3	+ 8	+ 3
Bridgeport	+ 4	+ 3	+ 2
Lower Hudson River Valley	+16	+14	+ 4
Poughkeepsie	+18	+15	+ 3
Upper Hudson River Valley	+13	+15	+ 8
Albany	+27	+24	+13
Schenectady	+ 1	+ 8	+ 4
Central New York State	+13	+11	+ 2
Mohawk River Valley	+ 5	+ 4	— 3
Utica	+ 4	+ 4	— 7
Syracuse	+16	+14	+ 6
Northern New York State	+15	+17	—
Southern New York State	+10	+12	+ 2
Binghamton	+12	+15	+ 2
Elmira	+ 7	+ 9	— 1
Western New York State	+ 8	+ 9	+ 3
Buffalo	+ 9	+ 8	+ 3
Niagara Falls	+ 5	+ 8	— 6
Rochester	+ 7	+11	+ 4
Apparel stores (chiefly New York City)	+26	+23	+ 2

Indexes of Department Store Sales and Stocks Second Federal Reserve District (1935-39 average = 100 per cent)

Item	1944	1945		
	Nov.	Sept.	Oct.	Nov.
Sales (average daily), unadjusted	206	171	197	235
Sales (average daily), seasonally adjusted	161	161	172	183
Stocks, unadjusted	166	174	175	173
Stocks, seasonally adjusted	146	161	155	152

STUDIES CONCERNING THE SECOND FEDERAL RESERVE DISTRICT

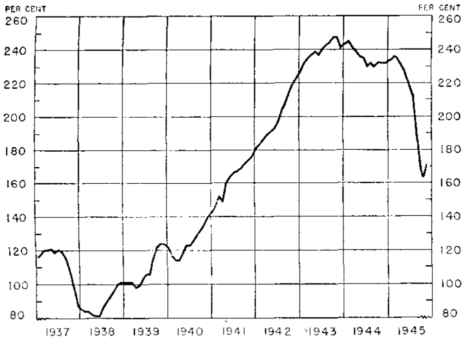
A number of studies of various aspects of economic activities in the Second Federal Reserve District, or parts of the District, have been made by the Research Department of the Federal Reserve Bank of New York and summarized in this *Review* during the past year. The more extensive studies on which some of these summaries were based are available in mimeographed form and will be supplied upon request.

Studies completed in 1945 include the following:

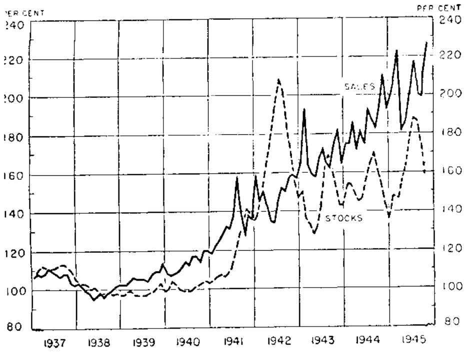
- Wartime Manufacturing Facilities Expansion in the Second District
- New York City's Commodity Exchanges
- New York City as a Center of Wholesale Trade
- Department Store Sales and Disposable Income in New York State, 1929-44
- Postwar Employment Problems in Paterson, N. J.
- Economic Trends in Northeastern New Jersey

The following additional studies, which were completed in 1944, are also available:

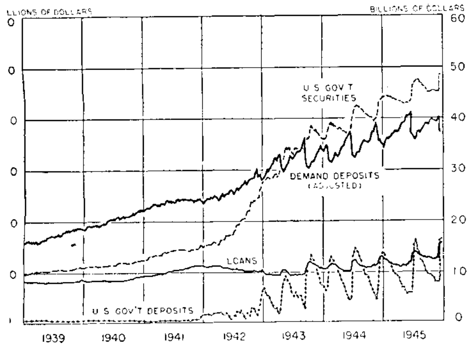
- The Working Population of New York City
- Manufacturing Industries in New York City
- New York City as the Corporate Capital of the United States
- Employment in the Financial Industries of New York City



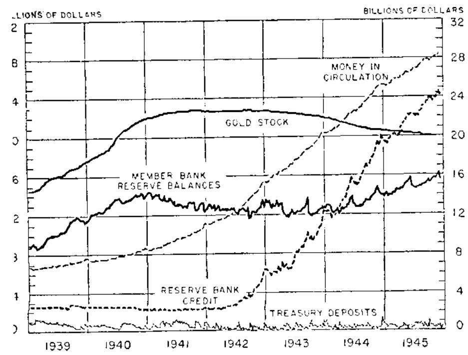
ndex of Physical Volume of Industrial Production, Adjusted for Seasonal Variation (1935-39 average=100 per cent)



Indexes of Value of Department Store Sales and Stocks, Adjusted for Seasonal Variation (1935-39 average=100 per cent)



Member Banks in Leading Cities. Demand Deposits (Adjusted) Exclude U. S. Government and Interbank Deposits and Collection Items. Government Securities Include Direct and Guaranteed Issues (Latest figures are for December 12)



Member Bank Reserves and Related Items (Latest figures are for December 12)

General Business and Financial Conditions

(Summarized by the Board of Governors of the Federal Reserve System)

Output at factories and mines increased considerably in November and activity continued to expand in most other lines. Value of retail sales reached new record rates in November and the early part of December reflecting in part further increases in prices.

Industrial Production

Output in most industries showed important gains in November and the Board's index of industrial production advanced about 5 per cent. The index, at a level of 171 per cent of the 1935-39 average, was about the same as in September and in the autumn of 1941. Output for civilian use in November, especially of fuels, industrial materials and producers' equipment, was larger than in those earlier periods. Production for civilians of many finished consumer products, however, like automobiles, radios, clothing, and shoes, while much higher in November than in September, was still greatly reduced from 1941 levels.

Steel production showed a large rise during November and in the first three weeks of December output was scheduled at an average rate of 83 per cent of capacity, which was higher than the November average. Activity at shipyards continued to decline considerably in November but increases occurred in most other metal fabricating industries. Further increases in output were indicated in plants producing electrical products and machinery and in the railroad equipment and automobile parts and assembly industries. Automobile production, however, was curtailed sharply in the last week of November and the first half of December by a strike in the plants of a major producer.

Lumber and glass production were at low levels in November owing partly also to industrial disputes. In the case of lumber, however, output in recent months before the West Coast strikes was below 1939 levels and one-third less than the rate in 1941.

Production of most nondurable manufactures and of fuels increased from October to November reflecting increased supplies of materials and labor and the end of work stoppages in the petroleum and coal industries as well as strong demand generally for these and most other goods for civilian use.

Incomes received by agriculture, business, and consumers appear to have continued to rise in November as a result of the widespread increases in production and employment and further rises in prices and wage rates. Payments to unemployed industrial workers and veterans also increased somewhat in November.

Employment in nonagricultural establishments rose by over 300,000 workers in November, after allowing for seasonal changes, reflecting increases in all major lines except Federal war agencies. A further decline of about 100,000 workers in munitions industries was more than offset by gains in employment in other manufacturing industries, mostly in reconverted metal-products plants. Employment in the trades and services, construction, and various other lines showed relatively larger increases than in manufacturing.

Distribution

Department store sales increased sharply in November and the Board's seasonally adjusted index rose to a record level of 228 per cent of the 1935-39 average as compard with 213 in October. November sales were 11 per cent larger than last year and in the first half of December sales continued to show about the same increase. Sales at some other types of retail stores, especially those selling automotive supplies, men's apparel, furniture, building materials, and hardware, have recently shown much larger increases than department stores, while sales of foods and various other products have shown somewhat smaller increases.

Shipments of most classes of railroad revenue freight showed less decline than is usual in November and the early part of December and were only 4 per cent below last year's high level. Carloadings of agricultural commodities and l.c.l. merchandise were considerably above last year's level.

Commodity Prices

Wholesale prices of most groups of commodities increased from the early part of November to the middle of December. With most farm products at ceiling levels, advances in prices of these products were smaller than in September and October. Ceiling prices were raised for newsprint, textile fabrics, building materials, and various other industrial products, but a general increase in steel prices was turned down.

Bank Credit

Loans and investments at banks in 101 leading cities increased by over 7 billion dollars during the six weeks ended December 12; this period covered the major part of the Victory Loan drive. Government security holdings increased by 3.7 billion dollars—a somewhat smaller rise than had occurred in the three prior drives. Loans for purchasing or carrying Government securities rose by 2.5 billion dollars, and at their mid-December levels loans both to brokers and dealers and to other bank customers slightly exceeded the high points of the previous drives. Commercial and industrial loans, which had been expanding since early fall, rose by an additional 800 million dollars during the six-week period. The increase in commercial credit extension has been at a rate substantially greater than at any time in recent years.

As payments for security purchases transferred funds from deposits of businesses and individuals to reserve-exempt War Loan accounts, the average level of required reserves at all member banks declined by around 500 million dollars during the first half of December. Early in the month, excess reserves rose to above 1.5 billion dollars on a weekly average basis. Subsequently, however, excess reserves declined somewhat, as the amount of War Loan deposits at many banks reached the maximum limits and banks turned over to the Treasury current receipts from sales of Government securities.

Currency outflow has continued at a slackened rate compared with wartime years; money in circulation increased by close to 350 million dollars during the six weeks ended December 12 compared with over 750 million in the 1944 period. On a seasonally adjusted basis, currency outflow has recently been at the lowest rate since the early part of 1941.