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MONEY MARKET IN FEBRUARY

The effects on the banking system of the large excess of Treasury tax receipts over Government disbursements and of the policy of employing surplus Treasury funds to redeem securities held by the Federal Reserve System were much more apparent in February than in the previous month. Pressure on member bank reserve positions was evident during most of the month. In January the drain on bank reserves due to heavy tax collections had been largely offset by a very substantial return of currency from circulation and by large Federal Reserve purchases in the market of Treasury bonds sold by nonbank investors, although the bond purchases were counterbalanced to a considerable extent by sales of short term securities. These offsets were either largely absent during the past month or were on a considerably diminished scale. Money in circulation showed little change during February, and Federal Reserve purchases of Treasury bonds diminished rapidly with each succeeding week of the month. Other offsetting transactions — net disbursements from foreign accounts with the Reserve Banks and a sizable decline in required reserves due to the reduction in demand deposits that resulted from heavy tax payments — fell far short of the losses of reserves through Treasury operations.

Commercial banks were therefore compelled to sell Government securities to maintain their reserves at the required levels. In addition some member banks found it necessary to borrow from the Federal Reserve Banks from time to time, and others drew down their excess reserves, which fell about 370 million dollars in the first three weeks of the month and then rose 150 million to 830 million in the week ended February 25. Week-to-week fluctuations in borrowings and in excess reserves were wide, reflecting largely the operations and changes in the reserve position of the New York City banks. However, member banks elsewhere tended on balance to reduce their excess reserves substantially.

Sales of Treasury bonds by commercial banks were substantial, particularly in the early part of the month and, judging from changes in the portfolios of weekly reporting member banks, may have exceeded net sales of all other types of Treasury obligations combined. In part, these sales of Treasury bonds reflected continued preparations by central reserve city member banks in New York and Chicago for the 10 per cent increase in their reserve requirements against demand deposits which became effective February 27. Thus, these banks preserved the liquidity of their Government security holdings by disposing of some of their Treasury bonds, instead of reducing materially their holdings of bills and certificates. In fact, member banks rather commonly appear to be placing considerable emphasis on an ample degree of liquidity in their investment portfolios.

In pursuance of the policy of discouraging unnecessary credit expansion by keeping bank reserves under some pressure, the Reserve System did not offer its Treasury certificates that matured February 1 in exchange for the new issue, but arranged with the Treasury to use accumulated tax receipts to redeem the entire amount of 1.6 billion dollars. In addition, the Treasury redeemed 100 million dollars of maturing bills each week during the month, and the Reserve System reduced its holdings of Treasury bills by more than that amount.

Despite these redemptions amounting to approximately 2 billion dollars, the Treasury's balances with the Reserve Banks at the end of February were only 300 million dollars lower than at the end of January. Tax collections continued substantially to exceed Government disbursements and resulted in a continuous drain on bank reserves and deposits. Near the end of February, the Treasury announced that it would use part of its accumulated funds to redeem the Reserve Bank holdings of about 460 million dollars of certificates of indebtedness maturing March 1 and bonds called for redemption on March 15.

The New York money market bore a substantial portion of the impact of Treasury operations, not only because of local income tax payments, but also because tax payments in other parts of the country were met in part by withdrawals of funds from New York City banks. Transfers of funds were made in considerable volume by out-of-town banks in need of reserves and by business enterprises and others making tax remittances in other parts of the country. The outflow of funds in the four weeks ended February 25 amounted to approximately 1.5 bil-

lion dollars. However, part of this outflow of funds represented transfers of the proceeds of sales of Treasury bonds and other securities indirectly to the Federal Reserve System, and thus did not affect the New York banks. Pressure on the metropolitan institutions, nevertheless, was considerable, and they were substantial borrowers from the Reserve Bank from time to time and sellers of sizable amounts of Treasury obligations of all types. Their excess reserves varied widely from week to week reflecting variations in the pressure on their reserve positions.

Shifts in Ownership of Government Securities

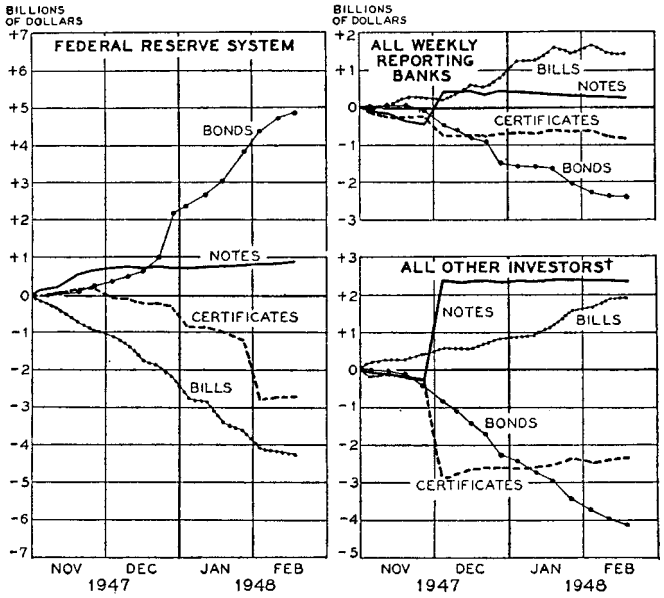
Operations of the Federal Reserve System in support of the Government bond market were carried out on a steadily diminishing scale during February. Purchases of bonds fell from 538 million dollars in the first week of the month to 81 million in the last week. Daily Treasury statements indicated renewed purchases of Treasury bonds for Government investment accounts in the latter part of the month, but the purchases were not large enough to affect the conclusion that a much reduced volume of buying was required to maintain the stability of the market. Purchases by the Reserve Banks of both bank-eligible and ineligible issues declined, and some market demand for the former caused prices of a number of eligible issues to rise above the support levels, thus eliminating the need for support of such issues.

The accompanying chart shows changes in holdings of the various types of Government securities by Federal Reserve Banks, weekly reporting member banks, and other investors during the period from the end of last October to February 18. Since the beginning of support operations early in November of last year, the Federal Reserve System has acquired nearly 5 billion dollars of Government bonds. About one billion of these purchases were made in the six weeks following November 12 and the remainder since December 24. In the first period, however, purchases of bonds for Treasury investment accounts were made in substantial volume, but these purchases were then discontinued until quite recently, so that the bulk of bond acquisitions since the third week of December have been made for Federal Reserve account.

In addition, the Reserve System acquired 900 million dollars of Treasury notes, mostly in the first six weeks of the sixteen-week period. Redemptions and sales of bills and certificates, however, more than offset the purchases of notes and bonds, so that over the entire period there was a reduction of about one billion dollars in total security holdings of the Federal Reserve System, and total Federal Reserve credit was reduced by a like amount.

These changes in System holdings reflect changes in the opposite direction in the portfolios of the weekly reporting member banks and other investors (including nonreporting

Changes in Government Security Holdings by Type of Investor*
(Cumulated weekly from October 29, 1947)



* Wednesday dates; latest figures are for February 18, 1948. Sharp changes in note, certificate, and bond holdings of reporting member banks and all other investors in the week ended December 3, 1947 reflect exchange of maturing bonds and certificates for a new issue of notes.

† Exclusive of the U. S. Treasury trust accounts and agencies.

banks and nonbank investors but excluding investment accounts under the control of the Treasury). Both reporting banks and all others sold substantial amounts of Treasury bonds, although some part of the decline in bond holdings early in December reflected the exchange of a maturing issue for new notes. The aggregate reduction for reporting member banks amounted to close to 2½ billion dollars, and for all other investors to about 4 billion dollars. Treasury bill holdings of both groups increased substantially, particularly in the second half of the period, the increase for reporting member banks amounting to about 1½ billion dollars, and for other investors to nearly 1.9 billion dollars. Changes in certificate and note holdings are obscured by the exchange of notes for certificates maturing December 1, but taken together reporting banks' holdings fell almost 600 million dollars and those of all other investors declined slightly over the entire period.

Reporting member banks failed to replace a substantial part of their holdings of bonds and notes with short term securities, largely because of their needs for reserves; they displayed a tendency to adjust their reserve positions more largely through sales of bonds than at any other time in recent years. Other investors used a large part of the proceeds of their sales of Treasury bonds and notes to purchase corporation securities and other private investments in the period up to the middle of January, although they also acquired substantial amounts of Treasury bills. Subsequently, they appear to have increased the relative amount of funds reinvested in Treasury bills.

To the extent that nonbank investors reinvested their funds in private securities or other private investment outlets or kept them on deposit with commercial banks, the pressure on the latter's reserves from other transactions (especially Treasury and Federal Reserve operations) was not as great as it might have been if nonbank investors had kept their holdings of Government securities intact. Nevertheless, sufficient pressure was exerted on bank reserves to cause the reporting banks to dispose of about 1½ billion dollars of Government securities since the close of October.

While substantial amounts of the sales of Treasury bonds by savings institutions undoubtedly have reflected a disposition to take advantage of the higher yields afforded by corporation and other securities and mortgages, the large-scale shifts from Treasury bonds to short term Treasury securities by commercial banks and nonbank investors in recent months appear to reflect an increased desire for liquidity. However, the reduced volume of selling of long term Government securities and the slight recession in yields on high grade corporate bonds in the past few weeks appear to reflect greater confidence in the prospect for stability in long term interest rates than prevailed some weeks ago.

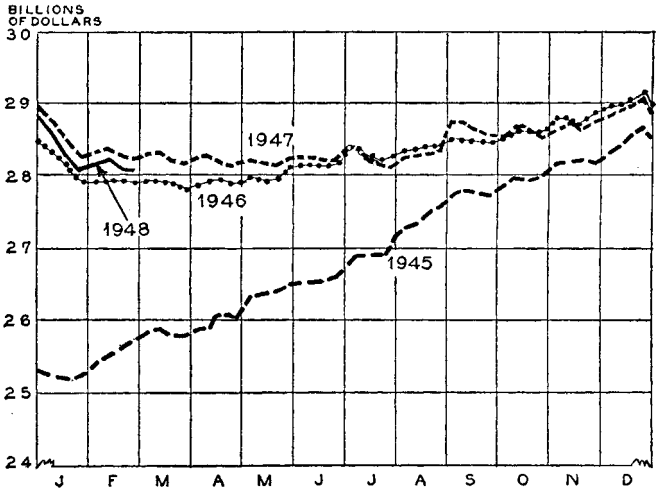
CHANGES IN CURRENCY CIRCULATION

Rising prices and wages, together with some increase in the flow of goods and services, caused a significant increase in the velocity of currency in circulation in 1947. Apparently some currency was taken out of hoarding to meet the greater demands, as the total amount of currency outstanding showed a net decline of 84 million dollars during the year. This decline, although small in relation to the total outstanding, is noteworthy because 1947 was the first year since 1938 to show a decrease in the amount outstanding.

Contrary to the rather general expectation that it would drop sharply after the end of the war, the amount of currency outstanding continued to increase, although at a reduced rate, until the end of 1946 and then tended to level off, as the accompanying chart indicates. During 1947, except for the temporary bulge in September when many veterans cashed their terminal leave bonds and withdrew the proceeds in currency, the seasonal pattern of the amount outstanding was similar to that in the mid-1920's when the average amount outstanding was fairly stable. During the first two months of 1948 the seasonal decline was somewhat sharper than in 1947; 814 million dollars were returned to the banks compared with 690 million during the same period last year. On February 25 the total amount outstanding was 28,054 million dollars, or 208 million below the corresponding figure last year.

While there has not been any very great change in the total amount outstanding since the end of the war, there have been

Currency in Circulation in the United States, 1945-48*



* Wednesday dates; latest figure is for February 25, 1948.

some significant shifts in the denominational composition of currency outstanding and in its geographical distribution. The share of $50 and $100 bills in total circulation had been growing ever since 1939 and continued to grow after the war, while the relative shares of the other denominations, which had shown mixed trends during the war, declined from 1945 to the end of 1947 (except in the case of coin).

At the end of 1939, as the accompanying table shows, $10 and $20 bills accounted for 44 per cent of the total amount of currency outstanding. During the war years these two denominations expanded considerably more rapidly than the total and at the end of 1945 they accounted for 56 per cent. Since that time the number of bills outstanding in the $10 and $20 denominations, as well as the number outstanding in smaller denominations, has been declining. The number of $50 and $100 bills, on the other hand, has continued to increase. Such bills now account for more than one fourth of the total amount of currency outstanding. The number of small bills ($1 to $5) continued to decline. At the end of 1947 they accounted for only one tenth of total currency outstanding compared with one fifth eight years earlier. The demand for coin, however, has continued strong since the end of the war.

The number of the largest denomination bills ($500 to $10,000) in use was reduced very sharply in the latter part of 1945 after the Treasury Department—as a part of its campaign against black marketeers and tax evaders—requested banks to report all unusually large deposits or withdrawals of currency, particularly in denominations of $50 or larger. The volume of such bills outstanding in the $500 to $10,000 denominations showed a further small decline in both 1946 and 1947.

The postwar shift from the small denominations to the $50 and $100 sizes probably reflects primarily the rising level of

Percentage Distribution of Amount of Currency Outstanding by Denomination, 1939, 1945, and 1947, and Year-to-Year Changes in Amount Outstanding by Denomination, 1945-47
(End-of-year figures; changes in millions of dollars)

Denomination	Percentage distribution			Year-to-year changes		
	1939	1945	1947	1944-45	1945-46	1946-47
Coin	8	4	5	+ 118	+ 87	+ 43
$1 to $5	21	12	11	+ 207	—156	— 46
$10 and $20	44	56	53	+2,776	—176	—413
$50 and $100	18	23	26	+ 398	+716	+355
$500 to $10,000	9	5	4	— 293	— 31	— 23
Total*	100	100	100	+3,208	+437	— 84

* Since the total includes a small amount of bills of unknown denomination, the figures do not necessarily add to the totals shown.
Source: U. S. Treasury Department.

prices. But it possibly also indicates a change in the population groups that are hoarding currency, or a change in the denominations that are being hoarded, or both. Apparently the smaller bills are being returned to active circulation (and to the banks) while the $50 and $100 bills are still being accumulated.

During the war the amount of currency in circulation increased proportionately more in the South and West than in most other sections of the country. Although the southern and western areas have retained much of their wartime gains in population and industrial activity, during the past two years there has been some reversal of the wartime trends in the geographic distribution of currency in circulation. The most marked change has been the very sharp drop in the amount of notes in circulation of the Federal Reserve Bank of San Francisco. The amount of these notes outstanding expanded particularly sharply during the war because they were used in Hawaii and the other Pacific islands. With the gradual demobilization of the military forces in that area after the Japanese surrender, a substantial amount of currency was returned to the San Francisco Bank. Between the end of 1945 and the end of 1947, that bank's outstanding note liabilities declined about 570 million dollars, or 18 per cent,[1] and the proportion of San Francisco notes to the total amount of Federal Reserve notes outstanding fell from 13 per cent to 10½ per cent (compared with 8 per cent at the end of 1939). Note liabilities of the Atlanta and Boston Reserve Banks have also contracted during the past two years, but to a much smaller extent.

On the other hand, the demand for money in the New York and Chicago Districts, which fell behind the rest of the country during the war, continued to increase in both 1946 and 1947, although at a declining rate. The note liabilities of the New York Reserve Bank increased by 7 per cent during the two years and accounted for 23 per cent of the total for the Federal Reserve System at the end of last December compared with 25 per cent at the end of 1939. The increase in the Chicago District during this period was 4 per cent. The St. Louis, Minneapolis, and Philadelphia Districts showed smaller increases.

[1] The amounts of Federal Reserve notes outstanding of each of the twelve Reserve Banks are not a precise measure of the total amount of currency in circulation in a given district, but changes in these amounts clearly indicate the trend.

THE DROP IN FARM PRICES

During February, widespread attention was focused on the nation's commodity exchanges, as a result of the sharp break in farm prices which occurred in the first half of the month. Declining prices in the commodity markets were also reflected in weakness on the stock exchanges and in some retail price cuts. But although prices were steadier on the whole during the latter part of the month, there was much discussion of the implications of the break with respect to business prospects—of the probable effects upon businessmen's plans, labor's wage demands, and consumers' attitudes.

The sharp drop in farm prices which started on February 4 had been preceded by a gradual decline in the previous three weeks, as shown in the accompanying chart. At the start of 1948, grain prices had been spurred to peak levels by the anticipation of continued pressure of domestic and foreign needs on short supplies. Spot prices of corn set an all-time record of $2.81 per bushel on January 15, and winter wheat prices advanced close to the postwar peak of $3.12 per bushel reached at the end of November 1947. The Bureau of Labor Statistics weekly index of wholesale prices of farm products reached 201.5 per cent of the 1926 average in the week ended January 17—a new record, 19 per cent above the monthly peaks in both 1920 and 1946. After mid-January, however, prices of many farm commodities declined slightly and intermittently. Wheat, corn, cottonseed oil, and lard in particular tended to weaken. The BLS daily index of the spot prices of seven domestic agricultural commodities, shown in the accompanying chart, declined about 5 per cent between January 12 and February 3.

February 4 marked the start of a sharp break in grain prices which was described as the most violent in the 100-year history of the Chicago Board of Trade. Prices of wheat for March delivery dropped 43 cents per bushel between Tuesday and Saturday, registering the maximum permissible daily decline of 10 cents on each of the last four days. Corn for May delivery likewise dropped the 8 cent daily limit for four consecutive days, and ended the week with an aggregate loss of 37 cents per bushel. Spot prices of wheat and corn showed declines of similar magnitude. Since no daily limit is fixed on price changes for spot transactions, wheat dropped over 15 cents on February 5 and corn prices fell 16½ cents on February 6. Prices of many other farm commodities traded on commodity

Changes in Selected Basic Commodity Prices at Primary Markets

Commodities	Percentage change			
	June 28, 1946 to postwar peak*	Postwar peak to Feb. 2, 1948	Feb. 2 to Feb. 13, 1948	Feb. 13 to Feb. 27, 1948
General index (28 commodities)	+ 80	— 4	— 8	— 1
Imported commodities (11)	+ 82	— 6	— 4	— 2
Domestic commodities (17)	+ 82	— 3	—10	0
Domestic agricultural products (7)	+ 66	— 4	—13	+ 4
Foodstuffs (11)	+100	— 5	—12	+ 2
Raw industrial materials (16)	+ 66	— 3	— 3	— 3
Selected foodstuffs				
Cottonseed oil	+188	—33	—13	+ 5
Hogs	+104	—10	—12	— 2
Corn	+ 94	— 7	—23	+11
Barley	+ 91	— 5	—13	+ 5
Steers	+ 90	— 8	—10	+ 2
Wheat (winter)	+ 67	— 8	—20	+ 2
Butter	+ 59	— 2	—11	0
Sugar	+ 50	—11	— 4	— 2
Selected industrial commodities				
Print cloth	+147	—11	— 4	— 8
Hides	+144	—15	—11	— 7
Steel scrap (Chicago)	+127	— 8	0	— 3
Lead	+ 83	0	0	0
Copper	+ 59	— 5	0	0
Wool tops	+ 44	— 2	— 5	+ 4
Cotton	+ 27	—12	— 9	+ 4
Rubber	+ 15	—18	— 3	— 4

* Dates of the postwar peaks for individual commodities and indexes vary from January 23, 1947 for rubber to January 29, 1948 for butter.
Source: U. S. Bureau of Labor Statistics.

exchanges declined in sympathy, particularly quotations for fats and oil seeds.

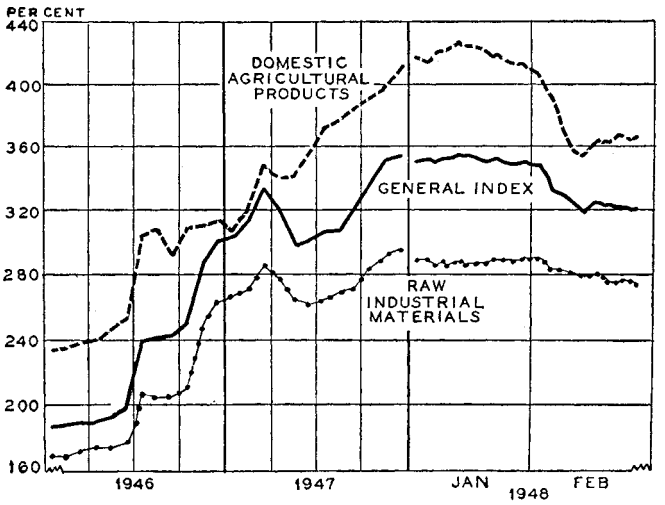
The declines continued in the second week of February, but were less precipitous. Despite short rallies in some commodities, most farm and food prices finished the week with substantial declines. The accompanying table shows the extent of the two-week drop in various basic commodities and groups of commodities. While the fall in prices of domestic farm products and foodstuffs was considerable, only minor declines were registered by imported goods and industrial raw materials. In fact, commodities in these last two categories (with one exception) declined from their postwar peaks relatively more prior to February 2 than they did in the ensuing two weeks. The reverse was true for all of the domestic agricultural commodities surveyed, except cotton. Cotton, however, dropped to approximately the level prevailing before decontrol; the only other commodities which declined close to that level were rubber and silk.

The reasons generally given for the break in prices center around the sudden realization that world supplies of grain, and of food in general, were much more likely to be in balance with demand in 1948 than had previously been anticipated. The rapid rise in grain prices since the middle of 1947 had carried them far out of line with most other commodities. When it appeared that the anticipated shortages which these high prices reflected might not be forthcoming, grain prices became vulnerable. January snowfalls improved the prospects for the domestic winter wheat crop, and favorable weather and crop reports were received from Europe and the Southern Hemisphere. Export prospects appeared particularly favorable in Argentina and Australia, and some offers of grain were forthcoming even from Eastern Europe. The Department of Agriculture announced that domestic stocks of wheat on January 1 were the largest in our history for that date, despite the shipment of more than half the 450 million bushels needed to meet our export goal. Also, less grain was used for livestock feeding than had been anticipated. A contributing factor was liquidation of stocks by farmers who, for income tax purposes, had held their 1947 crop until this year.

Once the price break started, there was widespread selling both for liquidation of long positions by speculators and for hedging of grain holdings by dealers. Lack of market support was attributed in some quarters to the 33⅓ per cent margin requirements imposed last fall. Soon after the initial drop it was announced that the Government had completed five sixths of its export buying, and would probably buy only 77 million more bushels of wheat in the next 5 months, unless the export goal was raised. Export allocations announced for March were also smaller than anticipated.

So far the spectacular price break has been confined to some leading farm products and foods. As the chart shows, there has been only a slight tapering off in prices of industrial raw materials, in contrast to the severe drop in agricultural products. In fact, prices of several important semifinished products, not included in the index, were raised during February. Price rises for worsted fabric are likely to cause increases in fall lines of men's clothing. Leading steel companies have advanced prices for semifinished steel products by $5 or more per net ton and have raised steel pipe prices by $6 to $10 per net ton.

Indexes of Daily Spot Market Prices, 1946-48*
(August 1939 average=100 per cent)



* For 1946-47, indexes are based on monthly averages of daily prices; for 1948, on daily prices. Latest figures are for February 25, 1948.
Source: U. S. Bureau of Labor Statistics.

These movements have been partly offset by declines in print cloth and hides (in both cases an indirect result of the break in agricultural prices), and in some other items, but the general level of wholesale prices of all commodities other than farm products and foods has been practically unchanged since the middle of January.

As the table shows, from February 13, the low point of the price break, to the latest available date, foodstuffs and agricultural products recovered slightly (one exception being hog prices). Farm prices are still above the mid-1947 levels, which at that time were already regarded as high in comparison with the levels of nonagricultural prices. Although farmers' anticipated 1948 income has shrunk by many millions of dollars in the past four weeks, it is evident that even at the present level of prices they would continue, as a group, to enjoy relative prosperity. In addition farmers' liquid savings are at a record level, and farm debt is extremely low. Inasmuch as the Second Federal Reserve District's dairy and poultry farms are consumers rather than producers of grain, the sharp drop in wheat and corn prices will be beneficial to this area.

In spite of the recent declines, prices of most commodities are still well above the price levels which the Government is currently committed to support. The support level for the 1947 wheat crop is at an average price to the farmer of $1.83 per bushel, equivalent to $2.08 at the Kansas City terminal market; on February 27, wheat was selling at $2.35 in Kansas City. The support price for corn is $1.37 on the farm; the February 27 quotation in Chicago was $2.23.

In retail markets, the price declines were chiefly in meats, shortening, flour, and other products closely dependent on the rapidly falling farm prices. In many cases the cuts were initiated by the large chains. A special survey by the U. S. Bureau of Labor Statistics, covering prices of twenty representative foods in twelve major cities, indicated a decline in retail food prices by the middle of February of 3 to 4 per cent from January's record level.

Prior to the recent break, there had been four or five temporary declines in farm and food prices since the end of the war, but none of them approached the magnitude of the present break. An indication of the impact of the recent drop in prices is furnished by the fact that on February 24 the BLS daily index of spot primary market prices fell below the corresponding date a year earlier for the first time in over seven years, the last previous year-to-year decline having occurred on January 22, 1941.

The break in farm prices has caused numerous comments and it has been interpreted in many ways. The prevalent view is that we have witnessed a selective readjustment of prices which were badly out of line with other commodity prices.

THE FRENCH FRANC READJUSTMENT

On January 25 the French Government devalued the franc by 44.444 per cent in relation to all other currencies, thus raising the official rate for the United States dollar from 119.107 to 214.392 francs.[1] At the same time, a free or open market was established for the United States dollar and the Portuguese escudo. This market, which functions at the Paris Bourse under the control of the Bank of France, is supplied with one half of the dollar proceeds from exports and with all other dollar receipts, especially those from tourist expenditures, noncommercial settlements, and the import or repatriation of capital. On the other hand, French residents must buy on the open market any dollars needed for the payment of imports that are payable only in dollars (except for some categories of "essential" imports, for the payment of which importers can obtain dollars from the Equalization Fund at the official rate of exchange), for all other payments except certain government payments, and for the export of capital from France.[2]

French exporters remain under obligation to turn over to the authorities all their accruing foreign exchange, except in the case of dollars and escudos, of which only one half must be surrendered at the official rate and the other half may be sold in the open market within one month after collection. Purchases of foreign exchange by French residents may be made only in accordance with the foreign exchange control regulations. Only importers who possess import licenses and buyers with special authorizations to purchase dollars for noncommercial purposes are admitted to the open market. As in the past, import licenses will be delivered solely for goods that are covered by the national import plan, and solely within the limits of that plan. The dollar proceeds accruing from the repatriation of French capital which has been held abroad without being declared to the authorities can be repatriated through the new open market, subject to a forfeit of 25 per cent in lieu of all taxes and penalties; this "legitimation tax" will rise by 1 per cent at the beginning of each month, commencing July 1, 1948.

Private transactions in gold, which were illegal in France, are now free, but gold exports or imports are still prohibited.

The above-described readjustment in the value of the French franc has produced a pattern of exchange rates at variance with that established by the International Monetary Fund. In the Fund's system the cross rates in any single market correspond in principle to the parities accepted by the Fund; and whenever they differ in fact, the exceptions are cir-

[1] Averages of official buying and selling rates. The devaluation applies also to the currencies of French overseas territories, with the exception of the franc of the French dependencies in the Pacific and the rupee of the French Settlements in India.

[2] "Free franc accounts" opened by residents of the United States with funds acquired by selling United States dollars or Portuguese escudos on the open market are freely convertible into dollars at the free market rate. They may be used for any payments in francs except the settlement of French exports.

cumscribed and, on the whole, unimportant. In contrast, France has now established an open market for the United States dollar that yields cross rates which seem to imply a premium for the dollar over sterling and other inconvertible currencies. The French determination to readjust the franc by "a more supple formula"[3] than devaluation pure and simple has consequently given rise to a dilemma with implications for the international exchange rate structure and for international financial policy that cannot yet be fully appraised.

A change in the value of the French franc was necessary and desirable. Between December 1945, the date of the last devaluation, and December 1947, French wholesale prices increased by 159 per cent and retail prices by 172 per cent in the face of far smaller increases in most other countries; yet the official value of the franc remained unchanged. This glaring and growing overvaluation of the franc undoubtedly contributed to the decline in France's total exports that began in May 1947. It was apparently responsible for the reduction in French exports to the United States from 63 million dollars in 1946 to 47 million in 1947, as well as for a shrinkage in exports going to the "convertible currency area" as a whole[4] from 14 per cent of total French exports in 1946 to less than 10 per cent last year. The preliminary balance of payments estimate for 1947 shows a current deficit of 1.6 billion dollars, of which 1.4 billion was on account of transactions with the "convertible currency area"; and for 1948 the estimated deficit substantially exceeds the amount of foreign financial aid (including aid through the European Recovery Program) that France may expect. Since official gold and dollar reserves have been largely exhausted, the difference can be made up only if vigorous measures are taken aiming at a revival of exports, the recapture of the tourist and other "invisible" income in convertible currencies that up to now has been disappearing in the black market, the voluntary repatriation of French capital, the dishoarding of gold and foreign assets, and the import of private capital from abroad.

These particular factors that underlie France's international position explain to a large extent both the objectives and the technique of the franc readjustment. First of all, in the present state of the French economy "it appeared impossible" to the French Government "to define a new exchange rate satisfactory for all transactions, commercial and noncommercial." In the view of the French Government, a moderate devaluation of the single-rate type would not have achieved its purpose, and a severe devaluation of this sort would have resulted in an excessive rise of French import prices. Secondly, French exports to the convertible currency countries were encountering increasing difficulties compared with those to other areas. Since in trade with countries having nontransferable currencies with nominal exchange rates the flow of trade is directed by intergovernmental negotiations rather than by commercial considerations, a franc readjustment appeared less needed with respect to those currencies than with respect to the convertible currencies. Finally, in order to recapture the tourist and other "invisible" balance of payment receipts, and induce repatriation and import of capital, it was felt by the French that the need was primarily not for a new fixed rate, but for an open market rate "established freely by the play of offer and demand." Those responsible for the formulation of the French exchange policy had uppermost in their minds the successful stabilization of the franc by Poincaré in 1926-28 and probably also the recent Italian experience with flexible rates. Furthermore, since the French Government had been determinedly seeking the gradual decontrol of the French economy, it undoubtedly viewed the establishment of an open exchange market, however limited and controlled, as a further step in the direction of economic freedom.

The international implications of the franc readjustment are manifold, but the crux of the matter is the scope of the open market. A good case can be made for the argument that, in the circumstances now prevailing in many European countries, noncommercial receipts and the proceeds accruing from the import and repatriation of capital will be traded on a recognized market only if the rate obtainable there is deemed appropriate by the prospective sellers; and that such a rate, on the other hand, could hardly be considered suitable for commercial transactions. Accordingly, the creation of an open market rate, in addition to an official rate, can be justified to a certain degree, and indeed the International Monetary Fund was prepared to accept such an open market rate in the case of France. "The Fund was not, however, able to agree to the inclusion, in a market with fluctuating rates, of any part of the proceeds of exports." However, the French Government deemed it impossible to confine the open market to "invisible" transactions and capital imports, presumably because elimination of the proceeds of exports would have deprived the market of the most substantial source of convertible currencies and would thus have made the rate obtaining there wholly unsuitable as a measure of the real value of the franc.

As a result of the establishment of an open market for the United States dollar, a pattern of cross rates has now developed in Paris in which the dollar appears to be quoted at a premium, the emergence of which may have far-reaching consequences. First of all, the Paris open market makes commodity arbitrage transactions theoretically possible. With the sterling parity at $4.03, the sterling-franc parity at 864 francs, and the average dollar export rate at 262 francs,[5] there is a theoretical pos-

[3] Unless otherwise stated, all quotations in this article refer to the official statements issued on January 25 by the French Government, the French and British Governments jointly, and the International Monetary Fund.

[4] Consisting, according to the French definition, of the Western Hemisphere, China, Japan, and Portugal, but excluding Switzerland.

[5] Average of the official rate of 214 francs and an assumed free market rate of 310 francs to the United States dollar.

sibility that French merchants may overimport goods from the inconvertible currency areas and reexport them to convertible currency areas. For inconvertible currency countries an entrepot trade of this kind would result in a loss of convertible currencies, since French exporters would thus be acquiring the dollar proceeds of goods which normally would be shipped direct by the inconvertible currency countries. As a matter of fact, of course, such transactions are limited by import and export controls, and by cost factors, especially shipping charges. However, should the exchange differentials be sufficiently large, the implementation of adequate controls might prove difficult, since the area calling for controls is extremely wide.

Apart from the possible diversion of trade through commodity arbitrage, the French rate pattern may prove discriminatory in the sense that it may tend to redirect French trade in a way detrimental to some countries. The new system gives French exporters an exchange inducement for export to the dollar area, while imports from the dollar area (except essentials) are retarded by the high open market rate; and conversely, French exports to nonconvertible currency countries are rendered less attractive, while the flow of imports from them is unchecked or possibly encouraged. These broad generalizations are obviously valid only in so far as special considerations do not require that the volume and the direction of trade be influenced by other means. France needs not only convertible, but also inconvertible currencies, as is apparent from the status of some of the French payments agreements. Accordingly, much will depend on the way in which the new exchange regime and the export and import licensing system are actually applied.

Under certain circumstances there might be scope in the French pattern for competitive depreciation. However, for the time being, the franc readjustment can be viewed primarily as a recognition of the price inflation in France to date and as an effort to restore France's relative international position. The rate governing France's exports to the United States works out at present at around 260 francs to the dollar, which corresponds approximately to the computed purchasing power parity as measured by the cost-of-living indexes of the two countries in terms of 1937-38 prices. Furthermore, French exports to the United States in 1947 constituted only 0.82 per cent of total United States imports, compared with 2.5 per cent of total United States imports in 1937-38. They could therefore treble without even restoring France's relative prewar position. A similar situation prevails, although in a lesser degree, with respect to French exports to other Western Hemisphere countries and to Switzerland. For example, French exports to Switzerland represent less than 11 per cent of total Swiss imports, compared with 14 per cent in 1937-38. To the extent, therefore, that the readjustment in the French franc results in restoring France's prewar share in the foreign trade of other countries, the new exchange policy does not appear to imply unfair competition.

The Bretton Woods Agreements provide that the International Monetary Fund, in making decisions during the transitional postwar period on requests presented to it by member governments, "shall give the member the benefit of any reasonable doubt."[6] The French Government referred to these provisions in its exchange policy statement; and it emphasized that the franc readjustment was essentially a transitional measure, an adaptation of the value of the French currency to "international economic realities" and a prerequisite for "a real and lasting stability, not an artificial and merely apparent stability." "In thus preparing for the stabilization of French economy," the French Government affirmed it was "making the best possible contribution to the reconstruction of Western Europe." On its part, the International Monetary Fund, in no sense "rigid or doctrinaire in its approach to this matter," did not object to the necessity and desirability of the franc readjustment, but opposed solely the inclusion of export proceeds in the open market, on the ground that the French move "entailed the risk of serious adverse effects on other members of the Fund." However, while regretting the French action, the Fund reasserted its willingness to "continue to work with France."

It should be possible for France and the Fund to agree upon the scope and nature of the adjustments needed in order to reconcile the new French exchange rate pattern with the framework of the international monetary agreements, and it is clear that both France and the Fund, not to mention the international community, would stand to gain from the earliest possible action along these lines.

[6] International Monetary Fund, Articles of Agreement, Article XIV, Section 5.

MEMBER BANK EARNINGS IN 1947

Net profits of all member banks in the Second Federal Reserve District declined sharply in 1947, owing principally to a heavy reduction in security profits although partly to rising expenses. The average net profit was 8.1 per cent of the slightly increased capital funds, compared with 11.2 per cent in 1946 and a record rate of return of 11.6 per cent in 1945.[1] Despite the 30 per cent decline in the past two years, the current level is still relatively high, being two-thirds above the average of the prewar years, 1936-39, and surpassed by a substantial margin only in the late twenties and in the past few years.

The decline in net profits relative to capital funds during 1947 was most pronounced among the larger sized banks of the District. In general, the larger banks sustained greater declines in the volume of security profits and required a larger propor-

[1] All percentages represent unweighted averages of the figures for individual banks.

tion of their income for expenses than the small banks did. Partly offsetting these adverse factors in the earnings of the larger banks were lower income taxes, due to the reduced level of taxable net profits; in the smaller banks, many of which are on a "cash basis," income tax payments were higher, as they were calculated against larger 1946 incomes.

Total operating income, except in the largest New York City banks, in which a moderate decline occurred, was greater in 1947 than in 1946. In general, the postwar increase in loans and loan income more than offset the reduction in interest received on a reduced volume of the higher yielding United States Government securities, which in turn reflected the effect of the Treasury debt retirement program. The divergent trends which have characterized these two primary sources of income, loans and Government securities, have progressed to a point where each now contributes approximately 40 per cent of gross income; in 1945, the last year of the war, the proportions were 49.2 per cent for Government security income and 28.8 per cent for loan income. Other gross income, consisting of income from other securities, service charges, and all other sources, declined slightly in importance during this period, accounting for 19.2 per cent of total income in 1947 compared with 22.0 per cent in 1945. Among the items of expense, salaries and wages and "all other" expenses, which consist largely of the physical costs of providing banking services, increased proportionately more than total earnings. Consequently, there was a moderate decline in net current operating earnings expressed as a fraction of gross operating income, even though the actual dollar volume of operating earnings in many instances was slightly higher than in 1946.

Selected Average Operating Ratios of All Member Banks Second Federal Reserve District

	1945	1946	1947
Number of banks	805	798	792
Percentage of Total Capital Accounts			
Net current earnings before income taxes	9.4	11.3	10.9
Profits before income taxes	14.0	14.7	11.4
Net profits	11.6	11.2	8.1
Cash dividends declared	2.1	2.2	2.2
Percentage of Total Earnings			
Interest on U. S. Government securities	49.2	47.7	40.5
Interest and dividends on other securities	8.0	7.2	6.6
Earnings on loans	28.8	32.3	40.3
Service charges on deposit accounts	6.4	5.8	6.1
Other current earnings	7.6	7.0	6.5
Total earnings	100.0	100.0	100.0
Salaries and wages	28.4	28.2	29.2
Interest on time deposits	16.4	15.9	15.8
Other current expenses	24.8	22.8	23.6
Total expenses	69.6	66.9	68.6
Net current earnings before income taxes	30.4	33.1	31.4
Net recoveries and profits*	15.5	10.6	1.8
Taxes on net income	7.8	10.1	9.4
Net profits	38.1	33.6	23.8
Percentage of Total Assets			
U. S. Government securities	61.3	60.0	53.2
Other securities	6.1	6.2	6.7
Loans	13.0	15.2	21.1
Cash assets	18.4	17.6	17.9

* Profits on securities sold or redeemed and recoveries on securities and on loans, less all charge-offs other than recurring depreciation on banking house and furniture and fixtures which is included in "other current expenses".

Net recoveries and profits on securities sold were reduced for the average member bank from 10.6 per cent of total current earnings in 1946 to 1.8 per cent in 1947. This decline was caused mostly by the much lower volume of security profits which accompanied the declining tendencies in prices of Government securities, especially in the latter half of the year. The volume of recoveries of previously charged-off assets and the volume of new charge-offs both were little changed from 1946 levels. This was the case even though the latter included for the first time charge-offs by a number of banks taking advantage of a recent ruling of the Bureau of Internal Revenue which permits them to set up reserves against loan losses based upon the loss experience of the past twenty years and to deduct such reserves in computing their income subject to tax.

Dividend payments remained conservative during the year, amounting on the average to 27 per cent of the net profits available for distribution. The persistent though small year-to-year increases which have been taking place since 1943, continued during the past year. The 1947 rise, however, merely kept pace with the growth in capital funds, and as a result, the ratio of dividend payments to capital funds remained unchanged at 2.2 per cent.

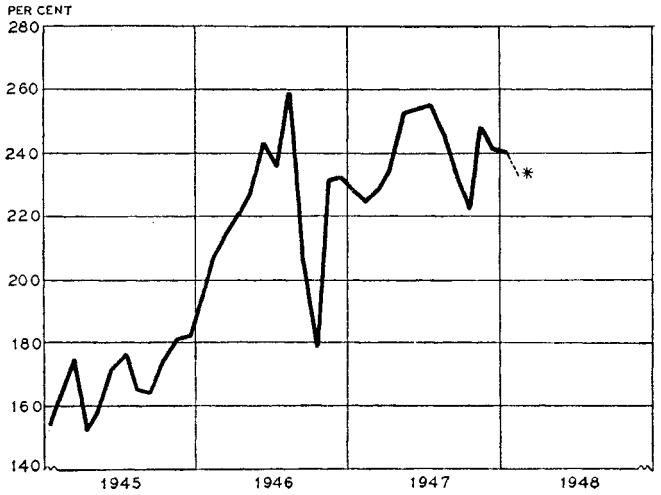
DEPARTMENT STORE TRADE

Although the daily average dollar volume of sales of Second District department stores during February was about 4 per cent larger than in February 1947, the increase over January was (on the basis of preliminary information) moderately less than the usual seasonal increase. Markedly improved weather for shopping and the appearance of new spring styles did not seem to affect department store trade during February as much as might have been expected. This last month is the sixth out of the past seven in which seasonally adjusted sales in this District have not increased.

As the accompanying chart shows, seasonally adjusted postwar sales, after rising rapidly to a peak in August 1946, have since oscillated around a level reached about the middle of 1946. A sharp dip in September and October 1946 resulted from the trucking and delivery strikes in New York City and in Newark. Inasmuch as aggregate consumer spending has continued to increase since mid-1946, department store sales appear to have suffered from higher food prices and increased sales of automobiles and of other durable goods by specialty stores.

The large New York City stores observed a very cautious buying policy throughout most of 1947. The retail value of inventory in the City's stores at the end of this past January was on the average 8 per cent less than its value a year earlier. In view

Index of Department Store Sales, Second Federal Reserve District, 1945-48
(Adjusted for seasonal variation, 1935-39 average=100 per cent)



* February 1948 estimated.

of year-to-year price increases the physical volume of inventory has undoubtedly been more sharply reduced than the decrease in the dollar figures indicates. Store inventories in the rest of the District present a mixed picture. Although at the end of January 1948 they were considerably greater in value in many areas than at the end of January 1947, they did not necessarily increase in physical volume, and in general were not far out of line with the recent volume of sales.

In preparation for an early Easter and in line with a more liberal buying policy which became apparent towards the end of 1947, the dollar volume of new orders placed during January by a group of stores for which information is available was considerably larger than during the corresponding month in 1947 (when stores were generally in the midst of a sharply retrenched buying policy). In contrast to inventory on hand, the volume of outstanding orders at the end of January was greater than a year previous, for the first time in 15 months.

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

Locality	Net sales		Stocks on hand
	Jan. 1948	Jan. through Dec. 1947	Jan. 31, 1948
Department stores, Second District	+ 5	+ 9	— 2
New York City	+ 5	+ 9	— 8
Northern New Jersey	+ 3	+ 7	+ 5
Newark	+ 5	+ 5	+ 2
Westchester County	— 6	+ 9	— 7
Fairfield County	+ 3	+ 7	+10
Bridgeport	+ 2	+ 6	+ 9
Lower Hudson River Valley	+ 5	+11	+17
Poughkeepsie	+ 8	+10	+14
Upper Hudson River Valley	+ 4	+ 9	+ 3
Albany	— 1	+ 9	+ 4
Schenectady	+10	+ 7	— 4
Central New York State	+ 5	+ 6	+ 3
Mohawk River Valley	+ 5	+ 9	+19
Utica	+ 5	+ 9	+16
Syracuse	+ 5	+ 5	— 4
Northern New York State	+11	+20	—
Southern New York State	+ 3	+ 9	+18
Binghamton	+ 2	+ 6	+14
Elmira	+ 4	+10	+25
Western New York State	+11	+ 9	+ 9
Buffalo	+12	+ 9	+12
Niagara Falls	— 2	+ 7	— 2
Rochester	+12	+ 8	+ 3
Apparel stores (chiefly New York City)	+ 1	— 4	— 7

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

Item	1947			1948
	Jan.	Nov.	Dec.	Jan.
Sales (average daily), unadjusted	183*r*	323	408	192
Sales (average daily), seasonally adjusted	228	248	241	240
Stocks, unadjusted	206	263	211	201
Stocks, seasonally adjusted	234	234	236	229

r Revised.

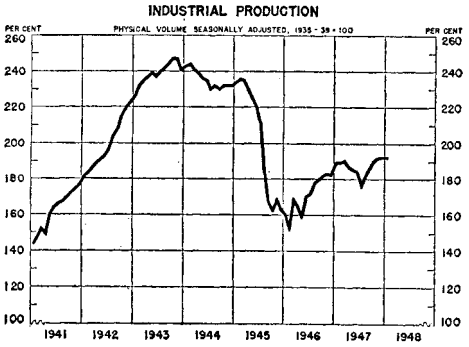
Indexes of Business

Index	1947			1948
	Jan.	Nov.	Dec.	Jan.
Industrial production*, 1935-39 = 100 (*Board of Governors, Federal Reserve System*)	189	192	192	192*p*
Electric power output*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	220	235	237	246*p*
Ton-miles of railway freight*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	199	211	202*p*	
Sales of all retail stores*#, 1935-39 = 100 (*Department of Commerce*)	282	325	330	326*p*
Factory employment				
United States, 1939 = 100 (*Bureau of Labor Statistics*)	153	157	158	157*p*
New York State, 1935-39 = 100 (*New York State Department of Labor*)	132	132	133	131*p*
Factory payrolls				
United States, 1939 = 100 (*Bureau of Labor Statistics*)	307	345	357*p*	
New York State, 1935-39 = 100 (*New York State Department of Labor*)	281	294	304	302*p*
Personal Income*, 1935-39 = 100 (*Department of Commerce*)	276*r*	298	306*p*	
Composite index of wages and salaries*‡, 1939 = 100 (*Federal Reserve Bank of New York*)	168	182	183*p*	
Consumers' prices, 1935-39 = 100 (*Bureau of Labor Statistics*)	153	165	167	169*p*
Velocity of demand deposits*, 1935-39 = 100 (*Federal Reserve Bank of New York*)				
New York City	80	97	87	88
Outside New York City	80	89	81	86

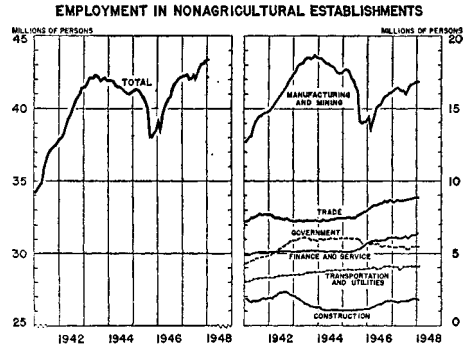
* Adjusted for seasonal variation. *p* Preliminary. *r* Revised.

\# Dollar figures for 1946 and 1947 and seasonal adjustment factors from 1942 to date have been revised.

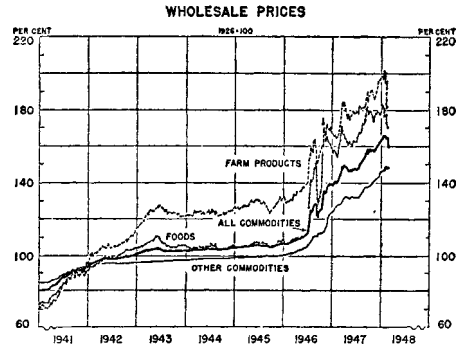
‡ A monthly release showing the 15 component indexes of hourly and weekly earnings computed by this bank will be sent upon request. Tabulations of the monthly indexes, 1938 to date, together with information on component series, sources, and weights, and reprints of articles describing the indexes may also be procured from the Research Department, Domestic Research Division.



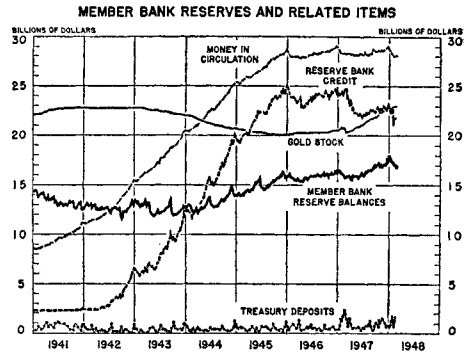
Federal Reserve index. Monthly figures; latest figure shown is for January.



Bureau of Labor Statistics' estimates adjusted for seasonal variation by Federal Reserve. Proprietors and domestic servants are excluded. Midmonth figures; latest shown are for January.



Bureau of Labor Statistics' indexes. Weekly figures; latest shown are for week ended February 21.



Wednesday figures; latest shown are for February 18.

National Summary of Business Conditions

(Summarized by the Board of Governors of the Federal Reserve System, February 26, 1948)

OUTPUT and employment at factories and mines continued to show little change in January. Value of department store trade declined by more than the usual seasonal amount in January and the early part of February. Prices of farm products and foods decreased sharply in the early part of February, while prices of most groups of industrial products showed little change.

Industrial Production

Industrial production was maintained in January at the level of the preceding two months, and the Board's preliminary seasonally adjusted index was 192 per cent of the 1935-39 average.

Activity in durable goods industries showed a slight decline in January. The decline reflected mainly some curtailment in production at steel and automobile plants in the latter part of the month owing to adverse weather conditions, which continued in the early part of February. Activity in nonferrous metals industries continued to increase in January; deliveries of copper and zinc to fabricators were at the highest level since the spring of 1947. Output of lumber and stone, clay and glass products was maintained at exceptionally high levels for this season.

Output of most nondurable goods recovered in January from the December decline. Activity at cotton textile mills reached the highest rate since the spring of 1947. Production at paperboard mills and printing establishments also increased. Petroleum refining activity rose further in January under the pressure of exceptional demands for fuel oil. Output of most other nondurable goods was maintained at the December rate or increased somewhat.

Production of minerals in January continued at the December rate. Bituminous coal output was restricted by weather influences on transportation and was 7 per cent smaller than in January 1947. Crude petroleum production continued to gain and was 14 per cent larger than a year ago.

Employment

Employment in nonagricultural establishments was reduced by 1,100,000 persons from mid-December to mid-January, mainly because of the usual large seasonal reduction in trade and Federal post office activities. Construction employment was curtailed more than is usual in January, owing to exceptionally severe weather conditions. Employment in manufacturing industries showed about the usual small seasonal decline.

Distribution

Department store sales showed more than the usual seasonal decrease in January and the Board's adjusted index declined to 282 per cent of the 1935-39 average, as compared with 303 in December and an average of 285 for the year 1947. Value of sales in the first half of February was 3 per cent above a year ago.

Total shipments of railroad revenue freight early in January equaled the volume for the corresponding period of 1947. In the latter part of January and in early February, however, loadings of most classes of freight were substantially curtailed as a result chiefly of weather conditions.

Commodity Prices

The general level of wholesale prices declined about 4 per cent from the middle of January to the latter part of February, reflecting mainly sharp decreases in prices of farm products and foods. Prices of hides, print cloth, and some other industrial materials also showed marked declines. Prices of semifinished steel and worsted fabrics, however, were raised and prices of most other groups of industrial products showed little change.

Retail food prices declined about 4 per cent in February from the record level of 210 per cent of the prewar average reached in January.

Bank Credit

Seasonally large Treasury receipts from tax collections and sales of Savings bonds resulted in a substantial transfer of deposits from private accounts at commercial banks to Treasury accounts at the Reserve Banks during January and the first three weeks of February. Accompanying drains on bank reserves were met out of excess reserves, from funds received from the post-Christmas return of currency and further gold inflows, and from funds supplied by market purchases of Government securities by the Reserve Banks.

Sale of Treasury bonds by commercial banks and other investors continued in January and the first three weeks of February, and the Federal Reserve System purchased substantial amounts of these issues. Total holdings of Government securities by Reserve Banks declined, however, reflecting sales of bills and certificates in the market, as well as Treasury retirements of securities held by Reserve Banks out of surplus cash receipts.

Government security holdings at member banks in leading cities declined somewhat in January and the first half of February as continued sales of Treasury bonds were offset only partly by purchases of bills. Loans to businesses showed little further change, but real estate and consumer loans continued to expand.

Effective on February 27, 1948, the Board of Governors raised from 20 to 22 per cent the reserve requirements to be maintained on net demand deposits by member banks in central reserve cities.

Security Markets

Common stock prices, which had moved downward during most of January, declined more sharply in the early part of February. Corporate bond prices were stable; yields on high grade issues averaged about 2⅞ per cent.