MONTHLY REVIEW

Of Credit and Business Conditions

FEDERAL RESERVE BANK OF NEW YORK

VOLUME 31 OCTOBER 1949 No. 10

MONEY MARKET IN SEPTEMBER

Money market conditions during the past month were influenced principally by Treasury transactions, including substantial net disbursements in the first half of the month and large quarterly income tax collections in the latter half. The devaluation of the British pound sterling and of numerous other foreign currencies was a dramatic development, of course, the ultimate consequences of which cannot be foreseen, but it apparently had little or no immediate effect upon the money market, except to the extent that buying of foreign exchange to cover import commitments was stimulated by the British announcement. Member bank reserve positions were easy in the two weeks ended September 14. During the rest of the month, however, the member banks lost substantial amounts of reserves as quarterly Federal income tax collections tended to swell Treasury balances with the Reserve Banks.

The final step, on September 1, of the progressive decrease in legal reserve requirements, announced by the Board of Governors of the Federal Reserve System early in August, provided the member banks with over 250 million dollars of free reserves during the week ended September 7. Furthermore, the Treasury's cash disbursements during the week ended September 7 exceeded by about 140 million dollars its receipts from taxes, sales of securities, and other sources, while the "float" (Federal Reserve funds credited to banks against checks still in the process of collection) rose 80 million dollars. These additions to bank reserves, and moderate net dollar expenditures by foreign countries out of the accounts maintained by their central banks with the Reserve Banks, provided the commercial banks with a substantial amount of funds. The only major loss of reserves to the banks came from the sharp month-end and Labor Day expansion of currency in circulation, amounting to 200 million dollars.

Member banks were consequently in a position to repay a part of their indebtedness to the Reserve Banks or to acquire additional earning assets. As a result, Federal Reserve loans and discounts declined substantially (415 million dollars), and there was also a moderate decline in System holdings of Government securities. The volume of Reserve credit thus retired absorbed more funds than the banks gained from current transactions and reduced reserve requirements, and, to make up the difference, the banks drew heavily on their excess reserves, which were reduced 270 million dollars during the week, to one billion dollars.

The nationwide gains in "free" reserve funds in the week ended September 7 were not uniformly available to all banks. New York City banks experienced only a minor net gain because the Treasury's receipts in New York were considerably larger than its disbursements. Nevertheless, the City banks retired most of their indebtedness to the Reserve Bank, thus sharply reducing their excess reserves, which had been raised, by borrowings, to an unusually high level at the beginning of the month to make up for preceding deficiencies. Most of the decline in member bank borrowings from the Reserve Banks in this week, therefore, reflected repayment of the New York City banks' indebtedness. The decline in excess reserves of the City banks exceeded that for all member banks, indicating that banks outside New York did not invest or otherwise employ all the funds made available to them during the week.

The approach of the quarterly tax collection period permitted the Treasury to forego calls on its deposits in special depository commercial banks after September 7. Consequently, in the week ended September 14, the Treasury continued to pay out more cash than it received, and with a further sharp expansion in Federal Reserve "float," a substantial return of currency from circulation after the Labor Day holiday, and continued moderate net expenditures from foreign accounts with the Reserve Banks, member bank reserve positions continued easy. A rise in required reserves accompanying a growth in deposits ab-

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sorbed only a portion of the member banks' increased reserves. The banks were again able to acquire additional earning assets during this week, and made substantial purchases of Government securities, a portion of which came out of Federal Reserve portfolios. Government security holdings of the System declined 163 million dollars. Not all the funds made available to the banks were used, however, and excess reserves rose 210 million dollars.

Most of the increase in surplus reserve balances occurred among the New York City banks, which had the benefit of net gains of funds not only from such current transactions as affected member bank reserve positions in the aggregate but also from a substantial inflow of funds, reflecting easy money conditions in other parts of the country. The City banks apparently chose to build up their excess reserve balances pending the expected substantial drain on reserves during the coming tax period, and they added only moderately to their holdings of Government securities.

The money market eased noticeably on September 15 when the Treasury paid out more than 400 million dollars, mainly interest on the public debt supplemented by the cash redemption of the small proportion of called 2 per cent bonds which were not exchanged for new certificates of indebtedness. This ease was short-lived, and member bank reserve positions tightened materially in the last half of the month, particularly in the closing statement week, as third-quarter income taxes reached the Treasury in large volume. In addition, the banks lost moderate amounts of reserve funds from other transactions. They consequently had to draw upon their excess reserves, sell Government securities, and increase their borrowings.

While funds were available during the week ended September 21, however, the banks made considerable purchases of Government securities, only a portion of which came from Federal Reserve portfolios. They also adjusted their reserves, by reducing their surplus balances with the Reserve Banks, which fell 610 million dollars. In substantial part, the banks' Government security purchases and the sharp decline in excess reserves reflected the operations of the New York City banks. Ordinarily the City banks bear a very large part of the drain on reserves during tax payment periods, since they lose funds not only through heavy local payments of taxes but also through large transfers of funds to other parts of the country for tax payment purposes. During the week ended September 21, however, owing to heavy payments of interest on the public debt in the New York market, the City banks gained funds from Treasury transactions, and the outflow of funds was lighter than usual for a tax period. Since their excess reserves were at a high level at the beginning of the week and were augmented on the first day of the week by heavy Treasury payments, the New York banks were able to meet the first heavy tax collections through reducing their excess reserves. At the same time they acquired substantial amounts of short-term Treasury securities, mainly bills. A substantial part of these purchases came from Government security dealers, who were able in this way to reduce their borrowings from the New York City weekly reporting banks by about 135 million dollars.

A temporary reserve deficiency arose on September 21 at the New York City institutions as a result of their Government security purchases. The deficit had to be corrected in the following week, and this, together with further losses through an outflow of funds, local tax collections, and other transactions placed the reserve positions of the New York City banks under considerable pressure in the final week of the month.

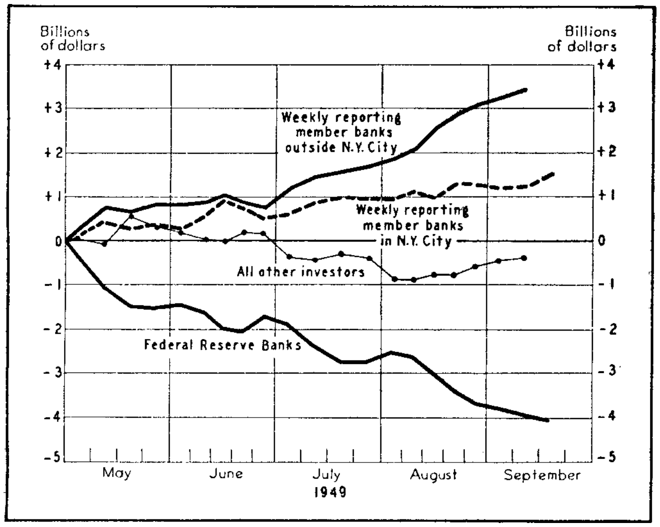
Over the month as a whole, the Federal Reserve System reduced its loans by 231 million dollars, but its Government security holdings rose 328 million dollars. While the System made substantial net purchases of bills in the market, chiefly in the last week of the month, its holdings of certificates of indebtedness declined (after allowance for the exchange of certificates for bonds called on September 15) in response to considerable demand for the longer maturities of this type of issue. As a consequence of this preference for the longer-dated certificates, rates on successive new Treasury bill issues continued to advance gradually, despite the fact that the Treasury suspended increases in the supply of new bills after September 8, thus holding the month's increase in the face amount of new issues to 200 million dollars. Government bond prices eased early in the month, firmed subsequently, and declined again toward the end of the month.

Member Bank Credit and the Reduction of Legal Reserve Ratios

The completion on September 1 of the third of three successive reductions in member bank legal reserve requirements brought the total reduction to an estimated 3.8 billion dollars in a period of about four months. Most of the reserves freed by the decrease in required reserves (which actually amounted to 3.4 billion dollars between April 27 and September 21 because of a rise in demand deposits) were invested in Government securities, a large part of which had to be supplied by the Reserve Banks in order to maintain orderly market conditions. The same was true of funds made available to the banks by other transactions, notably substantial net Treasury and foreign disbursements from accounts maintained with the Reserve Banks. Sales and cash redemptions reduced System holdings of Government securities by 4.1 billion dollars, and in addition member banks repaid, net, 120 million dollars of indebtedness to the Reserve Banks during this period.

However, a considerable volume of funds was made available indirectly for business and other purposes through the substantial purchases of Government securities which commercial banks made from nonbank investors and the Treasury, with resulting increases in bank deposits and the money supply.

Cumulated Net Changes in Holdings of Government Securities by Type of Investor, April 27 to September 21, 1949*



* Data for weekly reporting member banks include changes in holdings of nonmarketable issues which are probably nominal. Figures for all other investors relate largely to public marketable issues but are affected slightly by the nominal changes in weekly reporting bank holdings of public nonmarketable securities. Data for the Federal Reserve Banks cover changes in public marketable issues only. Latest figures available for weekly reporting member banks outside New York City and for all other investors are for September 14, 1949.

Thus, the Reserve System was not the sole source of supply of Government issues to the market. The weekly reporting member banks in New York City and 93 other leading cities made net purchases of 1.5 and 3.4 billion dollars of Treasury securities, respectively, thus acquiring not only the equivalent in amount of the System's sales and redemptions but also 800 million dollars of securities from nonreporting banks, nonbank investors, and the Treasury. The latter raised about 800 million dollars through increasing the face amount of its weekly bill issues during August and part of September. (However, cash redemptions of 600 million dollars of maturing or called securities cut the net increase in the marketable Government debt to 200 million since the close of April.) Nonreporting member banks probably made net acquisitions of Government securities in this period, inasmuch as their legal reserve requirements were also reduced. Sales of nonbank investors may therefore have been somewhat larger than indicated by the curve for "all other investors," shown in the accompanying chart.

Nonbank investors in turn used the proceeds of their sales to the banks partly to acquire new corporate security issues, thus making bank credit indirectly available to business, and partly to purchase large amounts of Treasury Savings notes, thus transferring some of the increase in bank deposits to the Government. Part of the funds made available to the Treasury in this way, and through sales of new bill issues to the banks, was likewise made available to business and agriculture as the Government spent the funds. A portion of the proceeds of Savings note sales, however, was permitted to accumulate temporarily in the Treasury's balance in War Loan accounts and will be routed to industry as the Treasury makes net withdrawals from these accounts during the next few months.

Expansion of Commercial Loans

During the period of the last series of reductions in legal reserve requirements, there was a modest expansion of business loans. This increase, however, most likely reflects seasonal credit needs. Total commercial, industrial, and agricultural loans of the weekly reporting member banks rose 345 million dollars between August 3 and September 14, but this was little more than 60 per cent of the advance in the corresponding weeks of 1948, and followed a decline of 2.8 billion dollars between December 22, 1948 and August 3, 1949. Nearly half this expansion occurred among the New York City banks, which have recently accounted for only about a third of the business loans of all weekly reporting banks.

The seasonal upswing in business loans usually gets underway in July, but was delayed this year until August. The current increase may reflect in part the recent moderate rise in general business activity and some rebuilding of depleted inventories. Until early September, the advance in loans of the out-of-town banks lagged considerably behind those of the New York City institutions. The more marked expansion of business loans of the New York City banks appears to reflect increased short-term borrowing by sales finance, public utility, tobacco, and other large, national companies which normally borrow largely in New York.

BANKING DEVELOPMENTS IN THE SECOND DISTRICT

In the three-month period ended August 31, representatives of the Federal Reserve Bank of New York called on banks in 49 counties in the Second Federal Reserve District. As a result they formed the following impressions of what bankers and businessmen in the areas visited were thinking about current business conditions, the business outlook, and banking policies and developments.

Those interviewed by our representatives were more optimistic about the future than they had been a few months earlier. Manufacturing activity was still well below the levels of a year ago, but numerous plants were reported to be stepping up their operations again. Retail trade was still feeling the impact of reduced incomes, but established merchants appeared to be moving their stocks again at a normal pace, assisted in some instances by clearance sales at lower prices. Inventories generally appeared to be in line with current sales, although shortages had shown up in certain lines, and some merchants were beginning to stock up in anticipation of brisker business in the fall. One exception in this picture appeared to be the farm machinery line, which had still been quite active in the spring. Inventories of farm machinery were reported to be backing up a bit as dairy farmers felt the pinch of lower milk prices and the early summer drought. The latter adversely affected early summer crops, but the prospect for fall crops was reported to be nearly normal.

In the agricultural areas, seasonal loan peaks were reached by banks in June, and some decline had taken place in recent weeks as the result of the repayment of farmers' borrowings. Elsewhere the loan trend varied, but generally speaking the portfolios of "country" banks outside the agricultural areas reflected no pronounced changes. Mortgages and consumer loans accounted for most of the new credit extended during the quarter, while the demand for business loans continued to lag. Some bankers commented that many borrowers seeking mortgage loans seemed to have more money of their own, which might be an indication that potential home owners, who had been waiting for price declines, were coming into the market. Loan delinquencies and requests for adjustments were reported to have developed, particularly in the areas where unemployment had been relatively high, but they did not seem to have assumed serious proportions anywhere. On the whole, loan rates had remained steady. In some of the more competitive areas, however, a tendency to shade rates for prime loans was reappearing.

Most banks reported very little activity in their investment accounts. Funds released by the recent reductions in reserve requirements had generally been invested in short-term Government securities. Some bankers had shown an increasing interest in municipal bonds because of their tax-exemption feature, and in railroad equipment obligations because of their slightly higher yields.

Deposits of banks in the agricultural areas were moving upward, as was to be expected during the mid and late summer periods. Elsewhere deposits showed no clear general trend, and in most instances any movement up or down had been moderate in amount and appeared to reflect chiefly some change in the local situation. Demand deposits in the industrial and residential communities had shown small but general increases in recent weeks. Time deposits of the commercial banks for the most part had either remained about the same or had shown some slight decline, which was generally explained as resulting from the competition of savings banks or savings and loan associations paying higher rates. The trend toward a 2 per cent interest rate was continuing among the savings banks, but with a few exceptions commercial banks did not appear to be giving much consideration to rate changes.

Construction activity was reported as varying quite widely. In the rural areas new construction had been almost entirely limited to small individual units built on contract or by the owner himself. In the New York commuting area, home construction continued at a high level but was confined principally to multiple housing units and to homes selling under $10,000. The market for existing dwellings had fallen off considerably, and for the first time in several years rental units were again becoming available.

The opinion seemed to be quite widespread that the business decline had just about come to an end, at least for the time being, and that it had constituted a healthy and needed adjustment. Most bankers, however, were still pursuing cautious policies pending further clarification of the economic picture.

CONSTRUCTION ACTIVITY IN 1949

The high national level of construction activity during 1949 has been a major factor in moderating the extent of the recent business decline. At a time when activity in most sectors of the economy was falling below last year's levels, construction during the first eight months of this year averaged somewhat higher than in 1948. For the entire year 1949, the dollar volume of construction work is expected to set a new all-time record. Since costs and profit margins in the construction industry have been declining, the increase in the physical volume of construction this year may be even greater than the rise in dollar value. The moderate increase in over-all construction activity conceals, however, a number of divergent tendencies among the several branches of construction and among the various geographical areas. Private construction in general has declined while publicly financed projects have increased sharply. Within the private sector there is less residential and industrial building than last year, but more construction by utilities and institutions. Also, in certain sections of the country the construction industry has made a much better showing than in others.

The value of private residential building during the first eight months of 1949 was 11 per cent less than in the corresponding period last year. During the winter and early spring there was a lull in housing construction, but in the past four months residential building has been picking up markedly, and the month-to-month increases in the value of work put in place have been greater than seasonal expectations. The same tendency toward expansion is apparent in the number of new homes started. Between 95,000 and 100,000 new permanent nonfarm dwelling units (both private and public) were started in each month from May through August; the work of completing these dwellings should prolong the current high volume of housing activity through the next few months.

Since the end of the war no consistent seasonal pattern in housing "starts" has emerged. In 1948 the number of dwelling units started reached its peak in April and May and declined steadily during the rest of the year, while in 1947 residential building made a slow beginning but increased each month until October. This year there has been a tendency for the number of "starts" to level out close to the peak during the summer months.

A greater number of the dwelling units started this year have been in the lower price brackets, largely because the demand for high-priced and even medium-priced homes has slackened considerably. The construction of low-priced homes has been facilitated by the use of simplified designs, improved supplies of materials, and the decline in construction costs. The last appears to have been more pronounced in residential building than in many other types of construction. The cost of frame-type construction, in particular, has been cut by marked declines in the prices of lumber and paint. As a result of this lower average price per unit, the value of housing work done has shown a sharper decline than has the number of dwellings started.

Private nonresidential construction activity as a whole has been maintained so far this year at about last year's rate. The level of commercial and industrial construction, however, was approximately one-fifth lower during the first eight months of 1949 than the exceptionally high level prevailing in the corresponding 1948 period. Many of the postwar programs of plant expansion have been completed, and the increasing emphasis on modernization and cost-reducing investment will involve greater expenditure for producers' durable equipment than for construction. The public utilities and railroads are still increasing their construction programs, although the rate of telephone and telegraph construction is tapering off somewhat.

Once virtually all the shortages of building materials had disappeared and construction costs had started to stabilize or to decline, many privately-financed community service projects got under way. The greatest relative increase in private construction—more than one third—has occurred in the various types of community service buildings—churches, hospitals, and private educational and recreational facilities.

One of the most significant developments in the construction field has been the marked increase in publicly-financed projects during 1949. A large backlog of public construction had been accumulated during the war and early postwar years, and many public authorities had also acccumulated the funds for financing these projects. As construction prices showed definite signs of leveling off, ground was broken for many Federal, State, and local projects, some of which had been on the drawing boards for many years. During the first eight months of 1949, public construction activity showed a gain of 30 per cent over the corresponding period last year, as contrasted with a decline of 6 per cent in privately-financed construction. Public housing activity has nearly doubled this year, construction of schools is up by two thirds, and public hospital

Changes in Construction Activity in the United States, New York, and New Jersey

Type of construction	Percentage change second quarter of 1948 to second quarter of 1949		
	United States	New York	New Jersey
Total	0	+23	− 1
Private	− 9	+ 3	− 5
Residential	−15	+ 5	+ 3
Nonresidential building	− 8	+ 7	− 21
Public utility	+ 7	− 7	+ 2
Public	+29	+71	+ 18
Nonresidential building	+77	+65	+119
Highway	+ 9	+69	+ 13
Sewer and water	+21	+66	− 22
Other public*	+28	+85	− 48

* Includes residential, military, conservation and development, and miscellaneous public service enterprises.
Source: Joint estimates of the U. S. Department of Commerce and the U. S. Bureau of Labor Statistics.

and institutional building is two and one-half times the 1948 level. Over a billion dollars was spent on highway construction in the first eight months of this year, even more than in the same period in 1948, when road building had already reached considerable proportions.

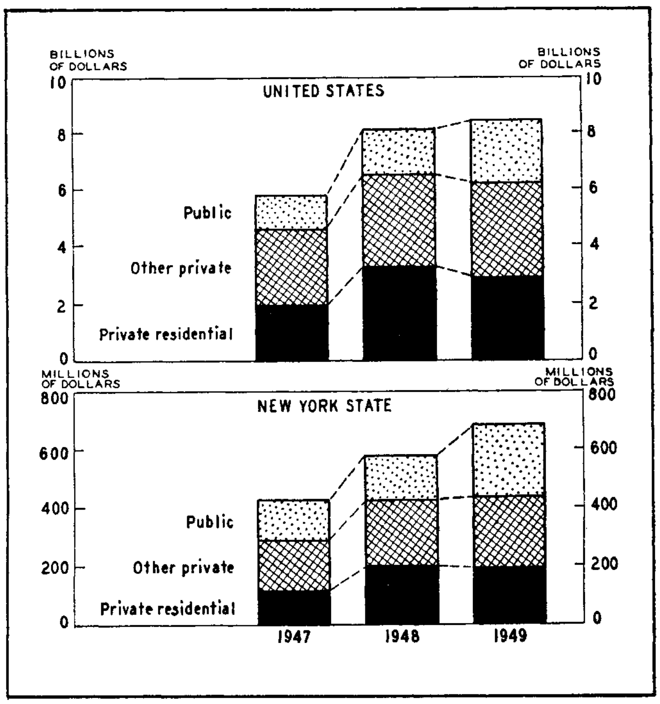
The impact of publicly-financed construction has been particularly noteworthy in New York State, as indicated in the accompanying table. During 1948, New York State accounted for 10 per cent of the nation's public construction, as compared with 6½ per cent of total private construction. Even so, the gains in public construction between 1948 and 1949 in this State were sharper than those in the rest of the country, and by the second quarter of 1949 (the latest period for which construction activity data by States are available), New York State accounted for fully one eighth of all publicly-financed construction activity.

New York leads all other States in the volume of highway construction work this year. After the end of the war, the State Public Works Department launched an 840 million dollar highway program, a key feature of which was a super-expressway extending from near New York City to the Pennsylvania border southwest of Buffalo. Material shortages and rising prices seriously delayed the program, but by September 1949 the State had awarded highway and bridge construction contracts totaling more than 250 million dollars, in addition to those financed by county and local authorities. New York is also the leading State in the volume of public contracts awarded during 1949 for hospital and institutional facilities, although it is third (behind California and Ohio) in school construction. Educational facilities have become an increasingly pressing problem as children born during the war years reached school age; New York City alone has been starting construction of new schools at the rate of one a month in the four years since the end of the war.

The phase of public construction activity in which New York State is particularly outstanding is public housing. During the first half of 1949, State and local housing authorities in New York awarded contracts for more than twice as much public housing as all other States combined. The 16,121 dwelling units started in New York City by State and City housing authorities during the first seven months of 1949 accounted for nearly three fifths of all residential construction started in the City and for more than two fifths of the State total in urban areas. A State-financed project involving 1,400 units was started in New York City in August, and a number of additional units of public housing are expected to be started before the end of the year. Outside New York City, seven State-sponsored projects in Mount Vernon, Troy, Schenectady, White Plains, Utica, Binghamton, and Port Chester accounted in the first seven months of this year for 1,872 dwelling units—more than one sixth of the total number of urban housing units started outside New York City during the period.

Private residential building in this District has also been maintained at a high level. During the second quarter of 1949, both New York and New Jersey showed an increase in private housing activity over the year before, whereas the country as a whole registered a drop of 15 per cent. Data on building permits issued indicate that most of the gain for this District occurred in unincorporated suburban areas, whereas privately-financed housing in both New York City and Upstate New York cities showed a decline from the 1948 rate.

Estimated New Construction Activity, United States and New York State, First Six Months, 1947-49*



* Value of construction work put in place (cost of materials installed plus expenditures for labor and overhead).
Source: Joint estimates of the U. S. Department of Commerce and the U. S. Bureau of Labor Statistics.

Particularly noteworthy is the greater volume of multi-family dwellings being built, both in this area and in the nation. Construction of rental units has been stimulated in part by liberalized mortgage insurance provisions. The number of privately-financed apartment units started in New York City during the first seven months of 1949 rose one third over the corresponding 1948 period, while the number of single-family and two-family homes started dropped by nearly one half.

As in other parts of the country, the volume of housing being built in the lower price brackets has been increasing. Builders in some portions of the metropolitan area claim that high land costs and local building codes keep them from producing homes selling for less than $10,000, but in other localities large numbers of such homes are being erected. Construction costs in the metropolitan New York and New Jersey area have declined 8 per cent between September 1948 and September 1949, with the bulk of the decline coming in the first half of the period, according to estimates of the Dow Service. Not only are building material prices lower, but output per worker has risen through improved work scheduling, greater availability of skilled labor, and the end of delays caused by material shortages. In addition, there has probably been an increase in the quality of workmanship and materials used.

The improved cost structure and the adequate supply of mortgage credit available here are factors favorable to continued large-scale activity in the construction of low-priced homes and apartments with moderate rentals, for which an extensive demand still exists. Public housing will be still further stimulated by the Housing Act of 1949. New York City alone is reported to have plans for 20,300 new dwelling units to be built during the next two years under the provisions of this Act, and other cities in this District have applied for low-rent housing projects totaling more than 18,000 units. In the case of higher-priced homes, however, the large volume of residential building in this area in recent years has relieved much of the pressure on the market and has sharply reduced the demand for homes selling for more than $20,000. Very little speculative building is going on in this price bracket, or even in the medium-price range. Completed dwellings in this category have been moving slowly, with occasional price concessions reported necessary in order to sell them.

THE DOLLAR PROBLEM OF THE STERLING AREA

The drain on the gold and dollar reserves of the United Kingdom that developed during the second quarter of this year signalized a dangerous setback not only to the British recovery effort but also to the entire European Recovery Program in which the United Kingdom plays so prominent a role. As an immediate consequence, the United Kingdom reluctantly decided to slash by 25 per cent its imports of goods payable in dollars. Even as a short-run emergency measure, this severe restriction of imports from the dollar area represented a damaging blow to the British economy. But a more alarming aspect of the dollar drain and the emergency import cuts was that these adverse developments should have appeared at a time when British industrial production had risen to 133 per cent of prewar levels, total export volume had attained a level 50 per cent higher than in 1938,[1] and total imports had already been drastically cut to 85 per cent of their prewar volume.[2] Perhaps even more ominous, the severe drain on the British reserves during the second quarter coincided with the receipt of ECA dollar assistance at an annual rate of 1,360 million dollars, close to the highest rate recorded in any quarter since inauguration of the European Recovery Program.

Beyond the immediate crisis loomed the danger that, in the absence of fundamental correctives, the 25 per cent cut in dollar imports by the United Kingdom would be succeeded only by a series of even more drastic limitations upon dollar imports as the flow of Marshall aid dollars gradually tapered off. If it were thus impelled by lack of dollar exchange to progressively curtail its dollar imports, the United Kingdom would have had no alternative but to resort to the slow and costly process of seeking sources of import supply within the sterling area, and in other areas with which discriminatory trading arrangements could be negotiated. Thus the dismal prospect would have been that of a steadily deepening cleavage of international commerce into dollar and sterling trading blocs, involving a progressive closure of both British and other foreign markets to United States exports and undoubtedly some deterioration of the standard of life in the United Kingdom and other nations of the sterling bloc.

The economic crisis that overtook the United Kingdom in the second quarter of the year, therefore, transcended the comparatively narrow limits of an internal British problem, and justifiably aroused anxiety throughout the world. With the swift deterioration of the British reserve position, the central issue which came to the forefront of international economic affairs was whether British trade equilibrium was to be achieved by means of an expansion of dollar earnings in a multilaterally trading world or by a curtailment of dollar expenditures and a resultant degeneration of international commerce into a stifling network of bilateral agreements.

It was of course not to be thought that both the short and the long-term problems of dollar balance in the United Kingdom's trade accounts could have been adequately solved, even with the utmost British effort and the best of international cooperation, during the few short months that have elapsed since the onset of the British crisis. Nevertheless, the discussions of the British economic problem undertaken by the Commonwealth finance ministers, the Council of the Organization for European Economic Cooperation, and more recently the United States, British, and Canadian delegates to the Washington conference have achieved encouraging progress. Quite aside from the concrete accomplishments of the several conferences, it is significant that there has been general agreement upon the basic objective of a progressive advance towards unrestricted multilateral trade. Thus, the British devaluation decision, taken prior to the Washington meeting (but announced subsequently), reflects the determination of the British Government to seek a solution to its trading problems in the competitive arena of multilateral trade instead of permanently sheltering an overvalued pound behind the protective barriers of bilateralism. For their part, the United States and Canada have undertaken to reexamine existing barriers to the entry of sterling area products with a view to the reduction of these barriers wherever possible. Simultaneously, however, there has been a general recognition of the imperative necessity of temporary deviations from the multilateral objective, such as the 25 per cent cut in dollar imports by the Commonwealth countries, in order to cope with the present emergency.

A useful starting point from which to appraise the dollar problem of the sterling area is the geographical pattern of the gold and dollar deficit of the area—a deficit that was running at an annual rate of roughly 1,900 million dollars during the first six months of 1949. Contrary to the common impression, this deficit was not incurred primarily on British account with the United States but rather was broadly distributed among a number of countries, both in the dollar area and elsewhere, that demanded settlement in gold and dollars, not only for deficits incurred by the United Kingdom but also for those of the overseas sterling area. British official estimates suggest that the gold and dollar deficit of the United Kingdom and overseas sterling area during the first six months of 1949 was roughly distributed as shown in the accompanying table.

Estimated Net Gold and Dollar Deficit of the Sterling Area, 1949
(In millions of dollars)

	First six months	Annual rate based on first six months
On United Kingdom account with dollar area	640	1,280
On overseas sterling area account with dollar area	148	296
On entire sterling area account with nondollar countries	168	336
Total	956	1,912

Source: Parliamentary Debate (Hansard), House of Commons, July 14, 1949 columns 803-4.

[1] Measured in sterling value terms, exports had risen to a level 279 per cent above that of 1938.

[2] In value terms, imports have been running 144 per cent above the prewar level.

Of the total deficit of the United Kingdom with the Western Hemisphere, the payments gap with the United States was initially expected by the British financial authorities to approximate an annual rate of 400-500 million dollars during the first six months of 1949. In view of the sharp decline in British exports to the United States in the second quarter of this year, however, the annual rate of deficit may actually have approached 600-700 million dollars, or about 30-35 per cent of the total gold and dollar deficit of the combined British and overseas sterling area during the first half of 1949. The residual deficit of the United Kingdom with Canada and other Western Hemisphere countries seems to have been at roughly the same annual rate as that incurred on United States trading account. The Western Hemisphere deficit of the overseas sterling area, for which the United Kingdom assumes responsibility, approached an annual rate of 300 million dollars during the first half of 1949, accounting for nearly 16 per cent of the total deficit of the entire sterling area. An even more severe drain upon British gold and dollar assets appeared in the form of a deficit of 336 million dollars (annual rate) incurred by the sterling area as a whole with Belgium, the German Bizone, Switzerland, Iran, and other countries that demand conversion into gold and dollars of their sterling acquisitions above certain agreed levels.

Appraised in the light of this distribution of the sterling area's dollar deficit, the decisions taken by the recent international conferences dealing directly or indirectly with the British economic problem assume a considerably greater significance. Considering first the deficit of the sterling area with Belgium and other nondollar countries, it should be noted that the Intra-European Payments Plan for 1949-50 will provide the United Kingdom with drawing rights and long-term credits of 102 million dollars to finance its expected deficit with Belgium. This represents an increase of 72 million dollars over British drawing rights upon Belgium in 1948-49, when the United Kingdom had to transfer to Belgium 76.5 million dollars in settlement of its Belgian franc deficit. British dollar losses to Western Germany should decline during the coming year as a result of recent agreements reducing Britain's dollar liabilities for support of Western Germany and providing for more liberal financing of the trade between the two countries. More significant from a longer-run point of view, it may be hoped that the recent devaluation of sterling in terms of the currencies of Belgium, Switzerland, Western Germany, and Iran will stimulate an expansion of British exports to those countries, with resultant relief from the serious deficits and dollar drains hitherto experienced. While it is of course impossible to estimate with any precision the beneficial effects of all these developments upon the British position, there would seem to be a reasonable prospect that the British dollar deficit with the nondollar countries may be substantially narrowed in the course of the coming year.

With respect to the deficit of the overseas sterling area with the Western Hemisphere, which rose to an estimated annual rate of nearly 300 million dollars during the first half of 1949, the July agreement of the Commonwealth finance ministers (excepting the Canadian minister) to cut the dollar imports of their countries by 25 per cent will, if put into effect, substantially narrow and possibly entirely close the dollar deficit of the overseas sterling area. During 1948, the imports of the overseas sterling area from the United States and Canada amounted to almost 1,600 million dollars. The recent loan of 34 million dollars by the International Bank to India may also help to reduce the total of drafts by the overseas sterling area on British dollar reserves during the coming year. In this connection, it should also be noted that the communique issued at the close of the recent Anglo-American-Canadian financial discussions recognized the desirability of achieving a more vigorous flow of private as well as public investment from North America to the undeveloped countries, and requested the President's Committee for Financing Foreign Trade to explore possible lines of action, with particular reference to the problem of incentives. The success of such efforts as may be undertaken to stimulate private investments of this sort could be a more fundamental and more satisfactory remedy for the disequilibrium in the overseas sterling area's balance of payments than enforced cuts in the area's dollar purchases.

A basic problem is that of further expanding the dollar earnings of the non-British sterling area, which amounted in 1948 to 1,096 million dollars as against the 289 million dollars earned by British exports to the United States. As was frequently suggested prior to the recent currency devaluations, there is considerable danger that price concessions on the primary commodities normally exported by the sterling area will not result in appreciable increases in the dollar value of the area's exports, owing to the relative insensitivity of demand to price cuts. Some encouragement to the recovery and growth of sterling area exports has been afforded, however, by the United States' agreement at the Washington conference to permit freer competition of natural with synthetic rubber in the American market and to review this country's program of stockpiling rubber and tin. Somewhat more specific stockpiling commitments were agreed to by Canada.

In general, the United Kingdom appears to have materially improved its chances of checking for the time being the dollar drain arising from the deficit of the overseas sterling area with the Western Hemisphere and the deficit of the sterling area as a whole with Belgium, Iran, and certain other nondollar countries. But the hard core of the British dollar problem is the deficit of the United Kingdom with the United States, Canada, and other Western Hemisphere countries, which was running during the first six months of 1949 at an estimated annual rate of nearly 1,300 million dollars.

Over the short run, the Western Hemisphere deficit of the United Kingdom should be substantially reduced by the 25 per cent import cuts announced in July by Sir Stafford Cripps. This restrictive action, coupled with the ECA 1949-50 allocation, should go far toward checking the loss of gold and dollar reserves in settlement of the British deficit with the Western Hemisphere. The dollar savings resulting from the scheduled cuts may amount to as much as 400 million dollars, while the OEEC has recently recommended an ECA allocation to the United Kingdom of 962 million during 1949-50. This allocation, together with those recommended for the other participants, will be subject, it is true, to some reduction in order to establish the reserve fund of 150 million dollars requested by ECA, but this downward adjustment should not seriously impair the British allocation. Neither does it seem likely that the United Kingdom will suffer serious losses of conditional aid as a result of the increased transferability of "drawing rights" provided for in the Intra-European Payments Plan for 1949-50.

It would thus appear that the United Kingdom has a favorable opportunity for stemming the dollar drain upon its gold and dollar reserves. In the longer run, however, much will depend upon the success of British efforts to resist increases in production costs and to raise industrial productivity, in order to consolidate the competitive advantage gained for British exporters through the recent devaluation. As Sir Stafford Cripps has so vigorously asserted, increases of money wage rates to British labor at this juncture would threaten to vitiate all of the progress that has been so laboriously achieved during recent months.

DEPARTMENT STORE TRADE

Sales at Second District department stores, stimulated early in the month by "back to school buying" of greater proportions than anticipated, rose in September more than seasonally, for the second successive month. During the week ended September 10, the dollar volume of Second District sales even showed a small gain over the corresponding week a year ago, reflecting heavy sales in New York City and Newark, but volume subsequently fell below last year's. For the month as a whole, according to a preliminary estimate, sales showed a reduction of close to 6 per cent, or about the same as the average year-to-year reduction for the preceding eight months of 1949.

Recent Inventory Policy

As on past occasions when business had fallen off, the current lag in sales has been accompanied by a relatively sharper drop in stocks. While during the eight-month period January-August 1949, dollar sales were running about 7 per cent below last year's volume, the drop in the retail value of stocks from the end of August 1948 to the same date this year was 16 per cent. There was some increase in inventory during August in preparation for the fall season, but it was of less than normal proportions; as a result, the seasonally adjusted index of stocks (at retail valuation) fell to the lowest level in close to three years.

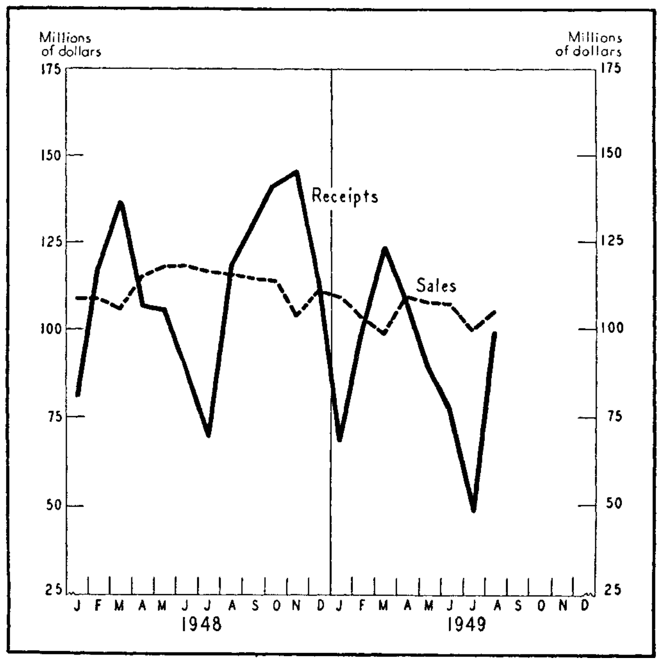
Stock-Sales Ratios*
Second District Department Stores

Month	1935-39 average	1948	1949
June	2.6	2.5	2.4
July	3.6	3.2	3.4
August	3.7	3.4	3.1
Three-month average	3.2	3.0	2.9

* End-of-month stocks divided by total sales during month.

The accompanying table shows the extent to which the stores have pursued an inventory curtailment policy since last winter. The August stock-sales ratio has been lower than this year's ratio of 3.1 only once since 1919, namely in 1946. (The corresponding ratio for 1935-39 was 3.7.) When the 1946 exception occurred, sales were growing so rapidly that stores found it difficult to keep inventories in adequate balance, in

Estimated Receipts of Incoming Merchandise and Sales of Second District Department Stores*



* Sales, but not receipts, are seasonally adjusted.

spite of a greatly extended forward buying position. Indeed, the stock-sales ratio was very low throughout most of 1946, reflecting in the main the inability of the stores to maintain the flow of incoming merchandise at the level of consumer purchases.

The very low ratio of stocks to sales for this past August may be traced to quite different causes. Beginning last November, the stores reduced sharply the amount of new orders and cut outstanding orders severely. Hence, not only were receipts of merchandise in 1949 smaller than during the corresponding months of 1948, as the accompanying chart shows, but they were deliberately cut below the current rate of sales. The drop in receipts between Easter and midsummer was sharper than usual for that period in the year. During July, at the trough of the seasonal decline, receipts amounted to less than 70 per cent of the estimated dollar amount for July 1948. The gap between sales and merchandise receipts was bridged through a reduction of inventories.

Towards the end of August and during September there were signs that retailers, in order to replenish the reduced inventories, had reversed their inventory policy. Without any great change in consumer demand other than the seasonal pick-up, the stores reentered the market vigorously, particularly for women's apparel and accessories. The dollar volume of new orders placed during August as a whole showed a greater than seasonal rise, and came to within 4 per cent or so of last year's volume, following cuts of 20 to 25 per cent in immediately preceding months. Reports generally characterize the aggressive buying by the stores during the past 5 or 6 weeks as a belated response to seasonal needs, stemming partly from too extensive preseason dependence on reorders. The District's garment trades were, therefore, stimulated into a particularly sharp seasonal burst of activity. Since manufacturers had been no less reluctant to carry inventory than the stores, spot shortages of particularly desirable fabrics developed, and in a few instances prices turned upwards.

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

Item	1948	1949		
	August	June	July	August
Sales (average daily), unadjusted	188r	224	155	171
Sales (average daily), seasonally adjusted	257r	238	222	234
Stocks, unadjusted	243r	206	189	204
Stocks, seasonally adjusted	243r	218	213	204

r Revised.

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

Locality	Net sales		Stocks on hand
	August 1949	Jan. through August 1949	Aug. 31, 1949
Department stores, Second District	−5	−7	−16
New York City	−6	−9	−17
Northern New Jersey	−5	−8	−15
Newark	−6	−9	−14
Westchester County	+10	+5	−4
Fairfield County	−4	−9	−20
Bridgeport	−4	−10	−21
Lower Hudson River Valley	−3	−6	−13
Poughkeepsie	−3	−4	−14
Upper Hudson River Valley	−5	−3	−18
Albany	−10	−4	−25
Schenectady	−2	−2	−12
Central New York State	−6	−8	−11
Mohawk River Valley	−10	−10	−14
Utica	−11	−9	−10
Syracuse	−4	−7	−9
Northern New York State	+2	−6	−24
Southern New York State	−9	−9	−15
Binghamton	−8	−8	−16
Elmira	−9	−9	−19
Western New York State	−5	−4	−13
Buffalo	−4	−1	−12
Niagara Falls	−8	−4	−15
Rochester	−8	−8	−13
Apparel stores (chiefly New York City)	−8	−8	−15

Indexes of Business

Index	1948	1949		
	August	June	July	August
Industrial production*, 1935-39 = 100 (*Board of Governors, Federal Reserve System*)	191	169	162	170p
Electric power output*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	253	256	255	258p
Ton-miles of railway freight*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	209	169	161p	
Sales of all retail stores*, 1935-39 = 100 (*Department of Commerce*)	338	332	328	329p
Factory employment				
United States#, 1939 = 100 (*Bureau of Labor Statistics*)	156	138	137	141p
New York State, 1935-39 = 100 (*NYS Div. of Placement and Unemp. Ins.*)	126	108p	106p	112p
Factory payrolls				
United States#, 1939 = 100 (*Bureau of Labor Statistics*)	360	316	313p	
New York State, 1935-39 = 100 (*NYS Div. of Placement and Unemp. Ins.*)	297	248p	247p	264p
Personal income*†, 1935-39 = 100 (*Department of Commerce*)	314	310	306p	
Composite index of wages and salaries*‡, 1939 = 100 (*Federal Reserve Bank of New York*)	193	198p	199p	
Consumers' prices, 1935-39 = 100 (*Bureau of Labor Statistics*)	175	170	169	169
Velocity of demand deposits*, 1935-39 = 100 (*Federal Reserve Bank of New York*)				
New York City	103	103	105	110
Outside New York City	96	86	88	89

* Adjusted for seasonal variation. p Preliminary.
# Revised beginning January 1941. †Revised beginning January 1942.
‡ A monthly release showing the 15 component indexes of hourly and weekly earnings in nonagricultural industries computed by this bank will be sent upon request. Tabulations of the monthly indexes, 1938 to date, may also be procured from the Research Department, Domestic Research Division.

NATIONAL SUMMARY OF BUSINESS CONDITIONS

(Summarized by the Board of Governors of the Federal Reserve System, September 30, 1949)

INDUSTRIAL production and employment increased in August and early September. Construction activity was maintained at advanced levels. Wholesale commodity prices rose slightly from mid-August to mid-September but subsequently declined. Department store sales increased somewhat after mid-August.

Industrial Production

The Board's seasonally adjusted index of industrial production advanced in August to 170 per cent of the 1935-39 average, which was slightly above the June rate. According to present indications the index may show a small further rise in September despite a work stoppage at coal mines after the middle of the month.

Production of durable goods rose 5 per cent in August, mainly because of substantial gains in activity in the iron and steel, nonferrous metals, and lumber industries. Steel output in August was at a rate of 82 per cent of capacity, the same as in June, as compared with 71 per cent in July. In September steel production has been scheduled at about 85 per cent of capacity. Assembly of passenger automobiles continued at record rates in August and early September, while truck assemblies declined, partly as a result of work stoppages at plants of a leading producer. Over-all activity in the machinery industries was maintained at the July level in August, as increased output of refrigerators and other consumers' electrical appliances offset further declines in industries making producers' equipment.

Nondurable goods production advanced in August to the highest level since March. There were large increases in output of cotton and rayon textiles, shoes, paper, paperboard, and tobacco products. Production of meat, seasonally adjusted, was maintained in August and early September and was at a level substantially above that of a year ago. Output of most other nondurable goods showed little change in August.

Minerals output increased in August, reflecting mainly a somewhat larger volume of coal production. Coal output in August, however, was one-third below a year ago. Crude petroleum production showed little change in August and advanced 2 per cent in early September. Iron ore production declined more than seasonally in August and early September.

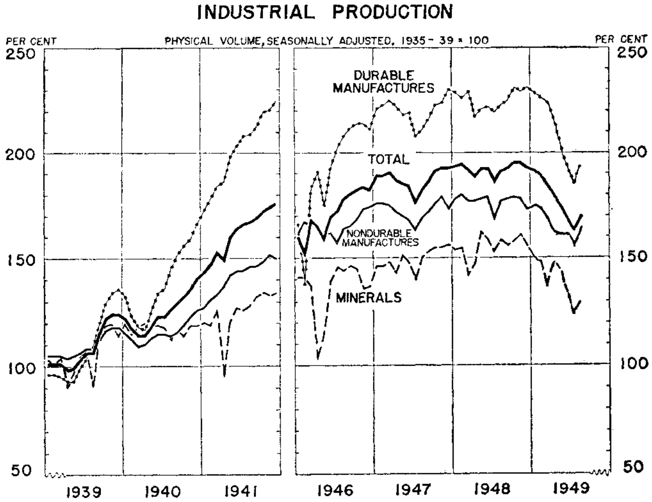
Employment

Employment in nonagricultural establishments showed somewhat more than the usual seasonal rise in August. Gains were mainly in manufacturing and State and local government employment. The number of persons unemployed declined from 4.1 million in early July to 3.7 million in early August.

Construction

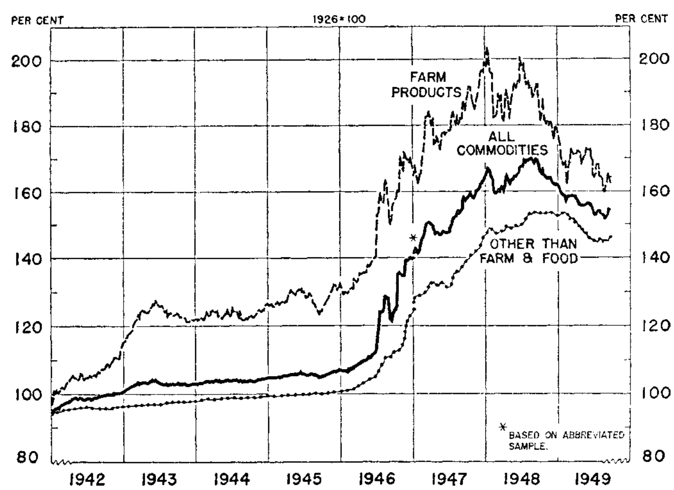
Value of construction contract awards in August, according to the F. W. Dodge Corporation, declined slightly from the high July level, but early reports indicate that awards in September regained the July level. The August decrease reflected substantial declines for most types of nonresidential construction, which more than offset a 15 per cent increase in residential contracts. The number of new housing units started in August, as estimated by the Bureau of Labor Statistics, totaled 98,000 compared with 96,000 in July and 87,000 in August 1948.

INDUSTRIAL PRODUCTION



Federal Reserve indexes. Monthly figures; latest shown are for August.

WHOLESALE COMMODITY PRICES



Bureau of Labor Statistics' indexes. Weekly figures; latest shown are for week ended September 20.

Distribution

Value of department store sales increased somewhat more than seasonally in August and the first half of September. The Board's adjusted index for August is estimated at 282 per cent of the 1935-39 average, compared with 279 in July and an average of 286 for the first eight months of the year. Sales of major household appliances have increased in recent months and have not been as far below year ago levels as they were earlier.

Railroad freight shipments in August and early September were above the July level, reflecting mainly gains in coal and numerous manufactured goods, but they subsequently declined again as a result of sharply curtailed coal shipments. Total carloadings in August were 19 per cent below the same period a year ago.

Commodity Prices

The general wholesale price index advanced somewhat from mid-August to the middle of September but subsequently declined again. These changes reflected to a large extent fluctuations in livestock and meat prices. Following devaluation of British and many other foreign currencies, generally by about 30 per cent, dollar prices of tin, rubber, and some other imported materials declined from 5 to 8 per cent. Prices of most nonferrous metals, following moderate advances in July, showed little change during August and most of September. Prices of steel scrap and of cotton and rayon cloth continued to increase.

Bank Credit

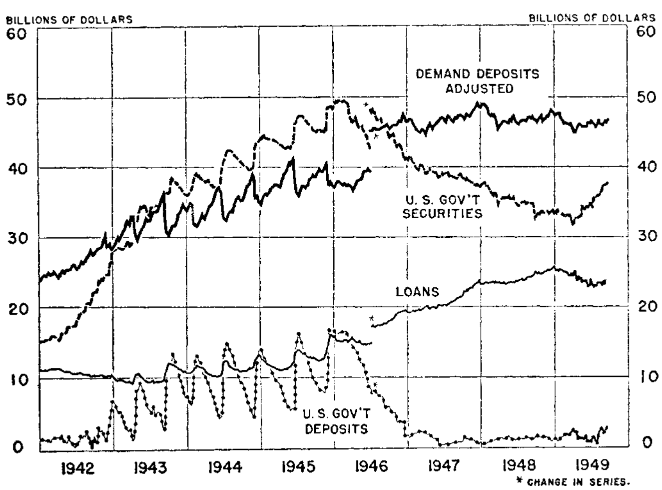
Business loans at banks in leading cities increased moderately during August and the first three weeks of September. Portfolios of municipal and corporate securities also were expanded somewhat. Holdings of Government securities increased over 2 billion dollars, reflecting in large part the use of the funds released by the reductions in reserve requirements in August and early September to acquire additional bills offered by the Treasury and to purchase short-term Government securities from the Federal Reserve Banks.

A reduction in Treasury balances at the Reserve Banks early in September supplied reserve funds to member banks. In the third week of the month Treasury balances were rebuilt through quarterly income tax receipts, and excess reserves of banks were reduced sharply.

Security Markets

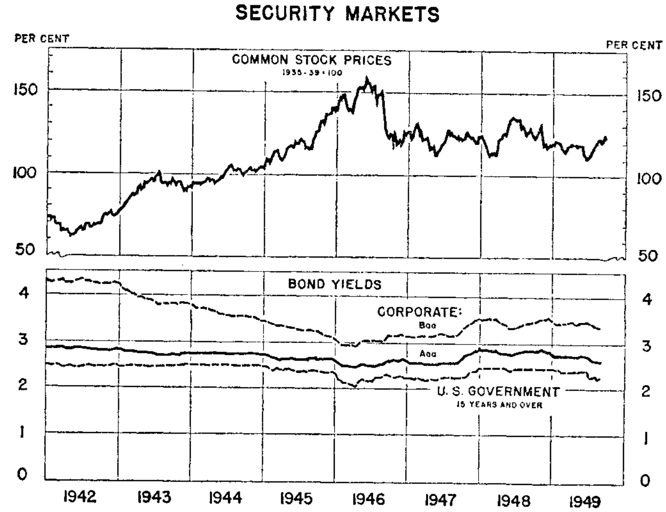
Prices of Government and high-grade corporate bonds showed relatively little change in the first three weeks of September. After rising in the second week of September to the highest level in nearly a year, common stock prices moved irregularly.

MEMBER BANKS IN LEADING CITIES



Wednesday figures; latest shown are for September 14.

SECURITY MARKETS



Common stock prices, Standard & Poor's Corporation; corporate bond yields, Moody's Investors Service; U. S. Government bond yields, U. S. Treasury Department. Weekly figures; latest shown are for week ended September 24.