MONTHLY REVIEW

Of Credit and Business Conditions

FEDERAL RESERVE BANK OF NEW YORK

VOLUME 32 MARCH 1950 No. 3

MONEY MARKET IN FEBRUARY

Money market conditions were rather tight during the past month, except for a temporary period of ease in the third week of February. Interest rates on Federal funds were 1¼ to 1-7/16 per cent during most of the month (only slightly below the Federal Reserve discount rate), and yields on short-term Government securities rose further. The average yield on new issues of Treasury bills advanced from 1.103 per cent on the issue dated January 26 to 1.119 on the issue dated February 9, and to 1.137 on the bills to be issued on March 2. Yields on Treasury certificates of indebtedness also rose slightly. These rates were influenced, not only by the firm money market conditions, but also by the Treasury's announcement on February 14 of its refunding program for March and April.

The announcement indicated that 1½ per cent notes maturing on March 15, 1955 would be offered in exchange for the 2 per cent bonds called for redemption on March 15, 1950 and for the 1⅜ per cent notes maturing on April 1, 1950, and that two 1¼ per cent Treasury notes both maturing July 1, 1951 would be offered in exchange for the two issues of 1¼ per cent certificates of indebtedness maturing on March 1 and April 1, 1950. Inasmuch as the new 1¼ per cent notes will mature in 16 and 15 months from the issue dates, as compared with the 20-month maturity of the note issue that was offered in exchange for certificates maturing on February 1, the new financing was viewed in the market as a further step in the direction of slightly higher interest rates on short-term Treasury obligations. As a result, Government security dealers quickly adjusted their quotations for outstanding securities. The two longest maturities of Treasury certificates and the most recently issued notes offered on February 1, 1950 (as well as the 1⅜ per cent notes of March 15, 1954 issued on December 15, 1949) sold slightly below par after the announcement.

Prices of Government bonds continued the irregular decline that began in January. Offerings of bonds for sale were not large, although a moderate increase in offerings developed in the latter part of February when the price of the longest issue of restricted Treasury bonds declined below 103, a price which had been regarded in some quarters as a possible "resistance point". On the other hand, there was a fair amount of demand for Treasury bonds on a downward price scale from investing institutions such as savings banks and stock insurance companies, and from trust funds and public investment funds. In addition, the commercial banks continued to buy moderate amounts of "bank-eligible" issues. The demand was met to a considerable extent by the Federal Reserve Banks.

Sales of Treasury bonds made by the Reserve Banks during the three weeks ended February 22 totaled a little more than 215 million dollars. Although such sales were larger in February than in the preceding month, the decline in bond prices was considerably smaller—about ⅜ of a point for the longest-term ineligible bonds, as against about ¾ of a point in January. Shorter maturities of Treasury bonds showed smaller declines.

MEMBER BANK RESERVE POSITIONS

Member bank reserve positions were under some pressure in the first half of the past month and again in the last week. On February 1 member bank borrowings from the Federal Reserve Banks amounted to about 455 million dollars. Repayment of a large part of this indebtedness early in the following reserve week placed the banks, particularly the larger New York City banks, in a tight position when, subsequently, they lost considerable amounts of reserve funds, mainly as a result of the security transactions of nonbank investors. The latter made substantial net purchases of Government bonds and short-term Treasury securities, a large part of which came

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from the Federal Reserve System's holdings. In addition, the commercial banks and others made sizable net purchases of new Treasury bills on allotment from the Treasury, resulting in a decline in the System's bill holdings. The pressure on the member banks' position caused by these transactions was only partly alleviated by net gains or releases of reserve funds resulting from other factors. These included a rather sizable increase in Federal Reserve "float" and a decrease in required reserves, which together were considerably in excess of losses of reserves due to a rise in currency in circulation, net Treasury receipts, and gold and foreign account operations.

In order to meet their net losses of reserves and to repay a portion of their borrowings, the member banks sold substantial amounts of Government securities in the open market, mainly Treasury bills and certificates. Despite cash redemptions of maturing bill issues, the Federal Reserve System's holdings of bills rose 63 million dollars in the two weeks ended February 15; market purchases of these issues were considerably larger than the net change in the System's holdings. The net increase in the System's portfolio of all Treasury securities, other than bonds, was about 110 million dollars.

The pressure on the member banks' position lifted somewhat during the third week of the month, chiefly as a result of large net Government expenditures, although other money market factors (notably a decline in Federal Reserve float) tended to absorb part of the banks' gains from Treasury operations. Member banks were able further to reduce their indebtedness to the Reserve Banks, and added moderate amounts of Government securities to their holdings, partly by drawing upon their excess reserves.

Most of the pressures on and subsequent easing of member bank reserve positions affected the reserves of the New York City banks. In considerable part, the Treasury securities which nonbank investors bought indirectly from both the commercial banks and the Federal Reserve Banks during the first half of February were paid for out of balances on deposit with the New York City banks, and a substantial part of the excess of allotments of Treasury bills over redemptions of maturing issues took place in New York. Much of the member bank indebtedness to the Reserve Banks at the beginning of February represented borrowings by the New York City banks, and, similarly, a large part of the subsequent retirement of this debt consisted of repayments by the City banks. The City banks thus were forced to sell substantial amounts of short-term Treasury securities (mainly bills and certificates) during the first half of the month. Since a sizable part of the securities which they disposed of were purchased by nonbank investors, resulting in little relief to their reserve positions, the City banks in the aggregate sold securities in substantially larger amounts than their reserve deficiencies before realizing sufficient reserves to adjust their positions.

Other money market transactions, on balance, alternately added to and afforded partial relief from the pressure on the New York City banks' reserves. In the third week of the month, an inflow of funds from other parts of the country resulting from net Treasury disbursements, together with transactions connected with the sale of a refunding issue of the International Bank, helped to ease the New York money market.

In the last week of February, the money market again became tighter as a result of a heavy outflow of funds to other parts of the country, apparently mainly as the result of an excess of Treasury withdrawals of deposits from Tax and Loan accounts in commercial banks and other receipts over Government disbursements.

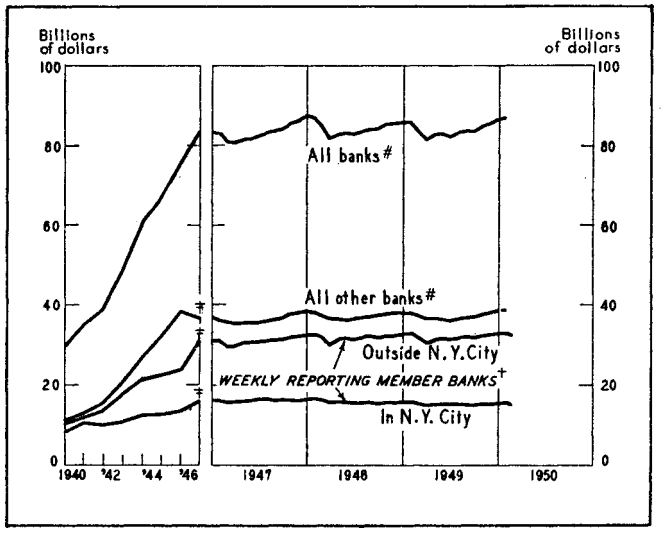
Member Bank Credit

Total loans and investments of the weekly reporting member banks declined markedly in the three weeks ended February 15, more than canceling the increase which had taken place during January following the post-Christmas return flow of currency and other gains of funds. The major factor in the February decline was a 1.1 billion dollar decrease in Government security holdings, mostly Treasury bills, reflecting the shift of holdings from banks to nonbank investors. Total loans rose almost 200 million dollars. In the week ended February 22, however, the security holdings of the weekly reporting New York City member banks rose substantially as money market conditions eased.

The rise in the total volume of loans at the weekly reporting banks in 94 centers during the three weeks ended February 15 was due chiefly to an expansion of loans on Government and other securities. Commercial, industrial, and agricultural loans reached a new high point for recent months on February 1, but declined somewhat in the following two weeks. In the case of the reporting New York City banks, a further moderate decline in such loans was reported in the week ended February 22. However, the volume of business and agricultural credits at all reporting banks has shown little seasonal contraction this year to date, reflecting a continued high level of business activity in the new year and, perhaps, a demand for agricultural credit (including loans guaranteed by the Commodity Credit Corporation). Real estate loans of the weekly reporting member banks have continued to advance to new peaks as construction activity has remained at high levels. All other loans (including consumer loans) declined slightly, but remained close to the peak reached toward the middle of January.

Measured from the end of 1949, total loans of weekly reporting member banks declined less than 70 million dollars by February 15, compared with a reduction of approximately 700 million in the corresponding period last year. The small

Adjusted Demand Deposits—All Commercial Banks and Weekly Reporting Banks
(1939-46 annually, 1947-February 1950 monthly*)



* Annual data are for either the last day or last Wednesday of December, monthly data are for the last Wednesday of the month.

\# Latest figures are estimates for January 25, 1950.

† Latest figures are February 15, 1950.

‡ The decline in the adjusted demand deposits of all other banks during 1946 and the increase for the weekly reporting member banks (particularly those outside New York City) reflected a revision of the weekly reporting member bank series rather than actual changes in deposits.

decline this year was the net result of a decrease of 125 million at New York City banks and an increase of 60 million at banks outside of New York. Total security holdings of all weekly reporting banks declined during the same period a little more than 325 million dollars, a decrease of 405 million in New York City being partly offset by an increase of 80 million in the other reporting centers.

Reflecting the continued increase in liquid savings of the public, time deposits of the weekly reporting member banks rose during the month ended February 15 to the highest level since June 1949. Adjusted demand deposits, however, receded as individuals paid their income taxes and nonbank investors purchased Government securities from the banking system. As shown in the accompanying chart, there has been comparatively little net change in the demand deposits of individuals, partnerships, corporations, and State and local governments in the postwar years since 1946. This is true not only with respect to deposits held at the weekly reporting member banks, but with respect to deposits in all other commercial banks as well. Such stability of deposits is in sharp contrast to the marked expansion of the war years. It reflects the cooperative efforts of the Federal Reserve System and the Treasury during 1947-48 to restrain the expansion of deposit money in the face of a huge expansion of business, mortgage, and consumer borrowing, a substantial inflow of gold from abroad, and some return of currency from circulation. A major factor in arresting the expansion of deposits in those years was the use of the Treasury's large cash surplus to retire Government securities held by the banking system, particularly by the Federal Reserve Banks. Other factors tending to check the growth of the money supply in the form of demand deposits were the efforts of the Federal Reserve System and other supervisory agencies to restrain the expansion of bank credit during the inflationary period, and the repayments of bank loans by business organizations during the recession in the first half of 1949.

One of the outstanding banking trends of the war and early postwar period—the much sharper expansion of deposits in other parts of the country than in New York City—was checked after 1947. However, the changes in deposits since that year have not been such as to restore the New York City banks' prewar share in the total volume of demand deposits. At the end of 1949 the New York City banks held only 18 per cent of total demand deposits, compared with 28 per cent in 1939.

CHANGES IN RESERVE CLASSIFICATION

Effective February 16, 1950, the reserve classification of three New York City member banks located in the Boroughs of Brooklyn and The Bronx was changed from a reserve city to a "country" bank status.[1] These banks hold very small amounts of correspondent bank balances and most of their business is local.

The change in the three banks' reserve status was made under Section 19 of the Federal Reserve Act, which authorizes the Board of Governors to make the application of the present rules governing reserve requirements more flexible by shifting banks in outlying areas of central reserve and reserve cities to classifications which require lower reserves.[2] Pursuant to this provision, the Board on February 8, 1950 amended its former rulings to read as follows:

> ". . . any member bank located outside the downtown business and financial district of Brooklyn . . . and having no branch in such downtown district or in the Borough of Manhattan, will be eligible for permission to maintain the reserves required to be maintained by banks located outside of central reserve and reserve cities.
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> "The boundaries of the downtown financial and business district above-mentioned are as follows: On the south, Atlantic Avenue from the East River southeasterly to Flatbush Avenue, then northwesterly on Flatbush Avenue and Flatbush Avenue Extension to the

[1] The three banks are: The Peoples National Bank of Brooklyn in New York, The Bensonhurst National Bank of Brooklyn in New York, and the Bronx County Trust Company.

[2] See "Reserve Requirements of Commercial Banks," in this *Review*, July 1948, pp. 71-73, and "Change in Reserve Requirements for Member Banks," November 1949, pp. 123-24.

East River. The remainder of the district is bounded by the East River."

* * *

". . . any member bank located in the Borough of the Bronx, and having no branch in the Borough of Manhattan or in the downtown district of Brooklyn . . . will be eligible for permission to maintain the reserves required to be maintained by banks located outside of central reserve and reserve cities."

These three banks are not the first member institutions in New York City to be classified as "country" banks. All banks situated in the Boroughs of Queens and Richmond with no branches in other boroughs had previously been classified as "country" banks. Twenty-five members of the Federal Reserve System in New York City are now classified as central reserve city banks, 9 as reserve city banks, and the remaining 14 as "country" banks.

FEDERAL FUNDS

In recent months frequent reference has been made in this *Review* to the New York City rate on Federal funds. It seems appropriate, therefore, to discuss briefly the place of Federal funds in the money market. What are Federal funds? Who wants them and who supplies them?

In the last analysis, Federal funds are the title to reserve balances with the Federal Reserve Banks. They are immediately available funds at the Reserve Bank as contrasted with other types of balances, such as clearing house funds (checks or drafts on clearing house banks) which in New York are not available until the day after their receipt.

The over-all supply of Federal funds is determined by the familiar factors of supply and use of reserve balances. For example, when currency in circulation or Treasury balances with the Reserve Banks go down, Federal funds tend to become more plentiful. On the other hand, when the gold stock, Federal Reserve "float",[1] or System holdings of Government securities fall, Federal funds tend to become scarce.

The reservoir of available Federal funds at times is smaller than the aggregate amount of *excess* reserves of member banks —first, because not all member banks wish to make their excess balances available to the market, and second, because excess reserves of certain banks may be immobilized to offset a previous (or an anticipated) deficiency in the current reserve requirement period. On the other hand, a bank may sell Federal funds even when its reserves are temporarily deficient if it is protected by "overages" (excess reserves) during the earlier part of the same reserve requirement period. Generally, however, a bank will supply Federal funds in the market only when it has excess reserves.

[1] For a discussion of the nature of "float" see the September 1949 issue of this *Review*.

In each banking center, local banks are normally the chief source of supply of Federal funds. Of late, however, sales of Federal funds have been made, on an increasing scale, by out-of-town banks also. Banks, moreover, are not the only suppliers and users of Federal funds. In fact, the supply of Federal funds which is put on the market by nonbanking institutions is quite significant. Chief among such suppliers are the Government security dealers. In the course of their operations these dealers frequently acquire title to Federal funds, either before such funds reach commercial banks or on the way from one bank to another. For example, when a dealer sells Government securities to the Federal Reserve System he receives payment in Federal funds. The dealer may sell the funds for other means of payment (such as clearing house funds), which he may deposit with his bank or use to repay his borrowings. Government security dealers also acquire Federal funds in other ways. They may have contact with nonmember banks or with local agencies of foreign banks in possession of Federal funds. In addition, they may acquire such funds through the sale of Government securities to nonbank investors which have obtained Federal funds (in the form of Treasury checks) from redemptions of Treasury issues.

The demand for Federal funds stems mainly from member banks which need to adjust their reserve positions. Many times it is cheaper to buy such funds than to borrow at the Reserve Bank. In addition, some banks have a tradition of not being in debt to the Reserve Bank. A few of the New York City banks, for example, have not borrowed from the New York Federal Reserve Bank for years.

When dealers buy Government securities from the Federal Reserve System, they need Federal funds in order to be able to make payment on the day the securities are delivered. They may need this means of payment also in order to do business with other investors which require cash settlement on the date of sale. Among such investors are corporations and State and local governments, all of which have been increasingly anxious to keep their funds invested in Government securities up to the day when the funds are needed for actual disbursements. Thus, they may sell Government securities on the day when their own securities must be paid off, or on the day when funds are needed for transfer to distant areas. As a result of such close timing, these groups of investors need immediately available funds.

Owing to their strategic position, Government security dealers not only participate in the Federal funds market but also contribute greatly to its functioning. For example, a bank in need of funds may indicate its needs to a dealer who, if he does not have the funds himself, may know some bank that does. He will also know approximately what the going rate is and will put the buyer in touch with the seller. Some

dealers will perform, even for a bank, the function of agent in placing or obtaining Federal funds.

In rendering such services, for which they make no charge, the offices of many Government security dealers become, in effect, a market place. Probably the most important *single* New York City market in terms of daily dollar volume of transactions, however, is in the offices of a Stock Exchange firm. This particular firm merely performs the service function of bringing buyers and sellers of Federal funds together and is in no way a participant in the market. After having determined their reserve positions from the clearing house settlements and from other transactions, some banks telephone the broker's office in the morning and indicate whether they are in need of funds or have them for sale; sometimes they also indicate approximate amounts. Buyers and sellers are then brought together by the broker and rates are agreed upon. This service and that of recording rate changes (or prospective changes) during the day is performed by the intermediary without fee or differential. Other banks in the City make little use of the services of an intermediary in their Federal funds operations, preferring to deal directly with one another.

The actual transfer of Federal funds within a given locality usually involves an exchange of checks. The lender gives a draft on the Federal Reserve Bank and receives a clearing house check payable the following business day. Ordinarily, the interest payment based on the number of calendar days[2] of use is included in the clearing house check, but some banks prefer a separate check covering the interest payment. Sometimes no interest is charged and the borrowing bank merely makes a commitment to return the same amount of funds upon demand or at a specified later date. Since this commitment involves risk in terms of the cost of the funds at the time of repayment, such "swapping" of funds is not a common practice.

An upper limit on the price of Federal funds is set by the rate at which funds may be borrowed at the Federal Reserve Bank. While occasionally the rate on Federal funds has exceeded the Federal Reserve Bank discount rate, this occurred in times of a shortage of paper eligible for rediscount or as collateral for advances. With the present supply of Government securities, the possibility of such an occurrence is very remote. Thus, in recent times the upper limit has been 1-7/16 per cent, just below the borrowing rate of 1½ per cent at the Federal Reserve Banks.[3]

Sales of Federal funds between banks in different banking centers are made by using the Federal Reserve wire transfer service. The lending bank transfers funds to the borrower on one day and a reverse shift is made the next day. In New York City, these transfers to and from out-of-town banks have increased of late. Ordinarily, only the large banks in other centers are involved. When banks in the City need Federal funds, their requirements are so great that the borrowing of small amounts of Federal funds is not worth the trouble. When funds are scarce elsewhere and relatively plentiful in New York City the same reasoning applies with respect to the lending of Federal funds by the City banks. A bank with an "overage" of 100 million dollars, for example, would not care to put itself to the trouble of parceling it out in lots of say, one million dollars.

The increase in out-of-town participation in the New York City market has contributed to a widening of fluctuations in the flow of funds in and out of this area. One day large amounts of funds will flow into the City and the next day large sums will flow out. The magnitude of these daily flows is often upwards of a hundred million dollars. Under such conditions the System's problem in gauging money market prospects and in conducting its operations in Government securities is made more difficult. The System, and the New York Federal Reserve Bank in particular, must take into account not only country-wide developments affecting member bank reserve positions but also the situation in New York City, which is by far the most important money market in the country. Anything that causes money market conditions in New York City to depart widely and unpredictably from those in the country as a whole complicates the System's problems, for it may give rise to a situation where one type of operation may be called for locally and another in the country as a whole.

It is obvious from the nature of the transactions that the sale of Federal funds is a loan and that their purchase constitutes borrowing; member banks have been directed by the System to treat them as such on their statements. This results in limiting the amount of Federal funds which may be sold by either National or State banks. With certain exceptions, a National bank is prohibited by the National Bank Act from lending to any one borrower more than 10 per cent of its paid-in capital and unimpaired surplus. New York State banks are subject to a similar limitation, except that undivided profits are included in the base. National banks, moreover, may be restricted in their purchases of Federal funds by the provision that aggregate borrowings of such banks cannot exceed their capital stock. There are no restrictions on borrowing by New York State banks.

In practice, borrowing limitations would be a hardship only to those National banks whose capital stock is very small relative to the fluctuations in their deposits and reserves. The loan

[2] Transactions are usually for a single day; but over week ends they are for two or three days, depending upon whether the participating institutions are open for business on Saturday.

[3] Actually a market rate of 1-7/16 per cent for Federal funds is even closer to the discount rate than the figures indicate. Federal funds are calculated on the basis of 360 days per year, while borrowing from the Reserve Banks is calculated on a year of 365 days. This has the effect of reducing the differential between the two rates.

limitation, on the other hand, makes it difficult at times for banks to dispose of large excess reserves.

Most of the above discussion of Federal funds relates to the New York City market, since that market is by far the most important one in the country. The trading in Federal funds in New York City consists for the most part of transactions between City buyers and sellers or between City banks and out-of-town institutions, but some of the trading involving out-of-town banks exclusively is also consummated here. Local markets do exist in a number of other banking centers, but the bonds between some of them (particularly the Philadelphia market and the New York market) are very strong. A few outside markets have rates which bear no close relationship to the New York City rates. This is true, for example, on the West Coast and in the St. Louis area, where a flat rate is charged to participating banks. However, most of the rate quotations in markets outside New York City are based on City rates.

THE SECOND OEEC REPORT

The Organization for European Economic Cooperation (the common agency of the countries receiving aid from the United States under the European Recovery Program) has issued a report, its second one, which gives cause for both satisfaction and concern. It is clear from a reading of this report that, as the ERP approaches the halfway mark, we can look back upon a record of accomplishment that has in many respects surpassed the progress initially anticipated. On the other hand, the OEEC report provides additional disquieting evidence that the most difficult obstacles to a closure of the dollar gap are still to be overcome.

The European economic crisis of 1947, which called forth the ERP, was fundamentally a crisis of production. The factories and fields of Western Europe, ravaged by war damage and the lack of repairs and maintenance, were then incapable of supplying the goods required for basic consumption needs without outside assistance in the form of consumer goods, raw materials, and capital equipment. Within less than two years, the dollar aid provided through the ERP has made possible a truly remarkable recovery of output, exceeding in many instances both the target objectives originally set and the recovery that followed the First World War. Particularly encouraging has been the restoration of food production, which has permitted a diversion of ERP funds from relief assistance in the form of consumer goods, to financing the capital development upon which the economic viability of the ERP countries must ultimately rest. Except in Turkey, the grain harvests in these countries had recovered by 1949 virtually to their 1935-38 averages, while the 1949 production of other staple food items, aside from milk and meat, either approximated or exceeded the prewar levels.

Industrial production has registered even more striking advances. The OEEC report estimates that over-all industrial output has increased by no less than 29 per cent since 1947, and is currently running at a rate 15 per cent in excess of 1938. The basis of this revival is well reflected in the OEEC estimates of increases since 1946 of nearly 30 per cent in hard coal production and of nearly 75 per cent in the output of crude steel. Textile production has regained prewar levels, machine tool production (excluding Germany) is 20 per cent above the 1938 rate, and earlier acute shortages of nonferrous metals, chemicals, and forest products have been substantially relieved. Road and rail transport facilities have been restored sufficiently to permit an even heavier flow of traffic than before the war. The merchant fleets of the ERP countries, reduced by 1945 to 58 per cent of their prewar tonnage, have been strengthened by domestic construction and purchases of United States tonnage until they now represent nearly 90 per cent of their prewar size. The total output of goods and services of all kinds by the ERP countries is estimated to have risen by roughly 25 per cent since 1947, to a point now in excess of the prewar level. (Since, however, the population of ERP Europe has meanwhile increased substantially, per capita production is probably still below the prewar level.)

This impressively swift recovery of output has facilitated, and simultaneously benefited from, a general stabilization of the internal finances of the ERP member countries. The OEEC notes that in four out of fifteen countries wholesale prices declined during 1949 below 1948 levels, while in only three countries did price increases of more than 10 per cent occur. Such relief from earlier inflationary pressure, both overt and suppressed, is largely attributable to the general improvement of fiscal and credit controls which, with other basic reform measures, has been so urgently recommended by both ECA and the OEEC since the inception of the program. But while the improved balance between the flow of goods and the flow of money enabled ERP Europe to weather the severe shock of the 1949 devaluations without undue strain, the report stresses that still greater efforts will have to be made to restrain the

Table I

Current Balance of Payments of ERP Countries*

(In millions of dollars)

	Calendar year				
	1947	1948	1949-50†	1950-51†	1951-52†
Imports (f.o.b.)	17,596	19,607	18,722	18,347	18,300
Exports (f.o.b.)	10,359	13,779	14,279	15,144	15,934
Balance of visible trade	− 7,237	− 5,828	− 4,443	− 3,203	− 2,366
Balance of invisible items	− 190	+ 844	+ 490	+ 785	+ 926
Balance on current account	− 7,427	− 4,984	− 3,953	− 2,418	− 1,440

* Excluding Switzerland.

† Fiscal year beginning July 1.

Source: European Recovery Program, Second Report of the OEEC, February 1950, p. 81.

domestic demand for goods and thereby release additional productive capacity for the export drive.

It is with respect to export earnings that the most resistant obstacles to a full recovery seem likely to be encountered. As regards over-all exports, it is true, much progress has already been achieved, and the export programs submitted to the OEEC by the various ERP countries (see Table I) forecast further substantial advances by the end of the Marshall Plan. But with respect to dollar earnings, both the actual and the anticipated progress reported by the OEEC falls considerably short of earlier hopes. This is shown by Table II, which provides a convenient summary of the anticipated developments in the gold and dollar portion of the aggregate balance of payments of the OEEC countries.

These OEEC estimates suggest that of the total reduction in the gold and dollar deficit from 8,500 million dollars in 1947 to an anticipated level of 2,250 million in 1951-52, increased earnings through merchandise exports to the United States and Canada will account for hardly more than 10 per cent, while improvement in the balance of current "invisible" items is expected to narrow the deficit by only a further 7 per cent. The decisive measures to narrow the dollar gap are apparently being taken on the dollar import side, where drastic cuts in imports from the United States and Canada are expected to account for more than 57 per cent of the anticipated reduction of the deficit. The remaining 26 per cent is expected to derive from an improved balance in the dollar transactions of the ERP countries with markets other than the United States and Canada, and from a similar improvement in the dollar accounts of overseas territories and of other areas whose currencies are linked with those of certain ERP countries. In these latter accounts, important gains in dollar exports may occur but cuts in dollar imports will probably also figure prominently.

Table II
Gold and Dollar Balance of Payments of ERP Countries*
(In millions of dollars)

	Calendar year				
	1947	1948	1949-50	1950-51†	1951-52†
A. Current-account payments of metropolitan areas with U.S.A. and Canada:—					
1. Imports	−6,719	−5,512	−4,316	−3,644	−3,150
2. Exports	+ 833	+1,218	+1,037	+1,255	+1,498
3. Invisibles (net)	− 499	− 144	− 153	− 111	− 82
4. Current balance	−6,385	−4,438	−3,432	−2,500	−1,734
B. Current balance of metropolitan areas with other dollar countries	− 527	− 631	− 397	− 275	− 152
C. Current balance of metropolitan areas with whole dollar area (A4+B)	−6,912	−5,069	−3,829	−2,775	−1,886
D. Other gold and dollar transactions of metropolitan areas:—					
1. Public and private capital operations	− 612	− 100e	− 129	− 196	− 312
2. Other gold and dollar transfers	...	− 259	− 214	− 234	− 161
3. Total	− 612	− 359	− 343	− 430	− 473
E. Total gold and dollar deficit of metropolitan areas (C+D3)	−7,524	−5,428	−4,172	−3,205	−2,359
F. Net gold and dollar transactions of overseas territories and associated monetary areas	− 976	− 194	− 201	− 53	+ 109
G. Total gold and dollar deficit (E+F)	−8,500	−5,622	−4,373	−3,258	−2,250
H. Financed by:—					
1. ERP and GARIOA**	...	+4,800e	+4,202	+3,072	+2,061
2. Other exceptional methods	+7,000	+ 822	+ 171	+ 50	...
3. Drawings on gold and dollar reserves	+1,500			+ 136	+ 189
4. Total	+8,500	+5,622	+4,373	+3,258	+2,250

* Excluding Switzerland. The term "metropolitan area" refers to the European territory of the ERP countries; it excludes overseas territories and associated monetary areas.

** Government and Relief in Occupied Areas.

† Fiscal year beginning July 1.

e Estimated.

Source: European Recovery Program, Second Report of the OEEC, February 1950, p. 84.

In appraising this prospect of a narrowing of the dollar gap primarily by means of dollar-import cuts, one should of course bear in mind that Western European imports from the dollar area were abnormally inflated in 1947 by acute shortages of domestic output which are now being overcome. Nor does the comparatively minor role assigned to an expansion of dollar export earnings necessarily imply that excessively modest export targets have been set, for the OEEC country programs schedule an 80 per cent increase of export earnings from 1947 to the end of the Marshall Plan; less than a quarter of this target increase seems likely to be accomplished by the end of June 1950. In this connection, the OEEC report rightly points out that the effort to close the dollar gap from the export-earnings side involves far more than a restoration of prewar markets. Even before the war, Western Europe's exports to the United States and Canada financed only a fraction of its imports from these areas; "invisible" receipts (tourist expenditure, shipping charges, etc.) and dollar earnings in third markets covered the difference. As a consequence the increases in dollar earnings that would be required to close the dollar gap by the expansion of exports alone are for most countries of almost impossible proportions.

As the flow of Marshall aid diminishes, the programmed cuts in the ERP countries' dollar imports may begin to bite into their essential supplies, with possibly adverse reactions on their domestic economies. And with such a compression of import programs to the rigid minimum requirements for basic foodstuffs and raw materials, the scope for emergency adjustments to crop failures or other unpredictable developments will correspondingly diminish. Moreover, the export targets that are now set assume that production levels in the United States will be maintained at the relatively high rates of the second and third quarters of 1949. But recent experience, the report argues, has shown that even minor setbacks in United States economic activity can have disproportionately severe repercussions upon foreign export sales here. All these

potential threats are rendered the more serious by the generally inadequate gold and dollar reserves of the OEEC member countries.

The outlook for the years after 1952, when the ERP will presumably have been terminated, is even more uncertain. According to the OEEC program schedule, there will remain in the year beginning July 1, 1951—the last year of the Marshall Plan—a deficit of 2,250 million dollars, against which, OEEC assumes, a final appropriation to the Economic Cooperation Administration of about 2 billion will be available. Since such a grant of 2 billion would represent 63 per cent of the total programmed imports of the ERP countries from the United States and Canada in the 1951-52 year, the scheduled cessation of dollar aid after mid-1952 may force truly drastic cutbacks in dollar imports. To a certain extent, the immediate impact of the termination of the Marshall Plan will be cushioned by the continuing arrival of shipments financed by earlier aid grants, while increased export earnings and further progress in the development of substitute sources of supply perhaps may also be expected to narrow the 2,250 million dollar deficit during the course of 1952-53. But, as noted by the OEEC report, it would seem clear that a serious problem will remain after 1952.

RECENT WAGE AND SALARY TRENDS

In contrast to the early postwar years, the contract negotiations between labor unions and employers which marked the opening months of 1950 were not the start of a new "round" of hourly wage-rate increases. Instead, most contract negotiations were carry-overs from last year. Even in 1949, no distinct pattern of increases in wage rates had emerged. On the average, hourly earnings of wage earners in nonagricultural industries rose only about 2½ per cent during 1949, compared with the previous "rounds" of wage increases averaging 7 per cent in 1948, 11 per cent in 1947, and 15 per cent in 1946.

The most significant collective bargaining developments in 1949 and so far in 1950 have involved not wage-rate increases but various types of pensions and social security benefits. In previous years, these had been lumped with other contract demands under the heading of "fringe benefits," but in 1949-50 the so-called fringe developed into the main issue at stake in negotiations involving many of the country's leading firms and industries. In fact, the idea of industry pensions had gained such a firm foothold that last year's steel strike and the current Chrysler strike involved not the question of whether a pension system should be established but the details of how such a plan should be financed or administered. Many hundreds of thousands of workers will be covered by new or expanded pension and insurance plans under contracts signed during the past six months. In general, these plans have been designed to supplement the Federal old-age and survivors insurance program, and many of the major contracts have followed the "Bethlehem formula," providing for noncontributory pension systems but jointly-financed insurance plans.

The failure of unions to gain greater wage increases during 1949 may be traced primarily to the falling off in business activity in late 1948 and early 1949 and to the gradual decline in living costs. The major contracts providing for pension benefits were generally not signed until the latter part of the year, when business had already started to revive. The direct effects of the pension and insurance plans on consumers' overall income and spending habits will probably be slight in the immediate future. The cumulative, long-run effects are much more difficult to assess. These will depend not only on the volume of benefits paid out but also on the impact of the employers' contributions on prices, dividend payments, and, indirectly, the savings patterns of wage earners.

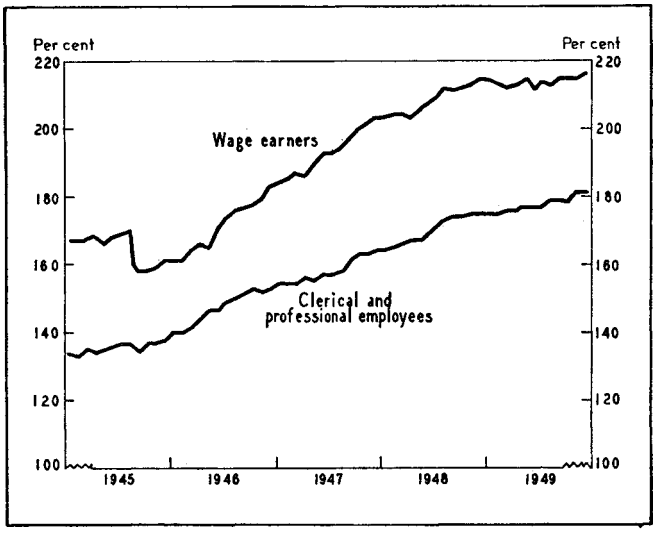
The relative stability of wages during 1949 is indicated in the accompanying table, based on the composite indexes of wages and salaries which this bank computes from data for individual industries published by the U. S. Bureau of Labor Statistics and other agencies. The only noteworthy change in hourly earnings occurred in the public utilities group (including transportation), which showed a 10 per cent increase between December 1948 and December 1949. This resulted largely from an increase which was awarded in March 1949, retroactive to October 1948, to nonoperating railroad employees and which was in reality a delayed "third round" of wage increases rather than a "fourth-round" raise. The large decline in weekly earnings in the mining industry reflects mainly the short work-week prevailing in the coal mines dur-

Changes in Indexes of Hourly and Weekly Earnings in Nonagricultural Industries
(Adjusted for seasonal variation)

	Percentage change to December 1949		
	From 1939 average	From July 1945	From Dec. 1948
Average hourly earnings			
Wage earners	+114	+41	+ 3
Manufacturing	+123	+36	+ 1
Mining	+112	+50	0
Public utilities	+100	+51	+10
Construction	+113	+41	+ 3
Trade and service	+110	+43	+ 2
Average weekly earnings			
Wage earners	+116	+28	+ 1
Manufacturing	+133	+20	0
Mining	+107	+ 9	−20
Public utilities	+ 96	+31	+ 4
Construction	+136	+31	− 3
Trade and service	+103	+41	+ 3
Clerical and professional	+ 81	+32	+ 3
Average weekly earnings, all groups	+105	+29	+ 1
Composite index of wages and salaries*	+103	+39	+ 3

* Weighted average of index of hourly earnings of wage earners and index of weekly earnings of clerical and professional employees.

Indexes of Weekly Earnings in Nonagricultural Industries, 1945-49*
(Adjusted for seasonal variation, 1939 average=100 per cent)



* Revised from September 1946 to date.

ing December 1949. Gains in weekly earnings during 1949 were generally in those categories which had shown the smallest over-all gains since 1939. Thus, the weekly earnings of employees of public utilities and trade and service establishments had lagged behind other groups, but in 1949 they rose 3 to 4 per cent. On the other hand, weekly earnings of factory production workers showed practically no change between December 1948 and December 1949. The same contrast is shown in the chart; while the weekly earnings of clerical and professional employees continued to advance during 1949, those of wage earners, in general, showed but little change from the level reached at the end of 1948. Wage earners, however, have increased their weekly earnings 116 per cent above the 1939 average, while the clerical and professional group has attained a level only 81 per cent above that prevailing in 1939. It should be noted that the average workweek prevailing in factories and other nonagricultural establishments was longer in 1949 than in 1939, whereas the general trend of hours worked in offices has probably been downward.

In view of the 2 per cent decline in the index of consumers' prices, the moderate rise in average weekly earnings of both the wage-earning and the clerical-professional groups during 1949 reflects some gains in real income for those employed. While the composite weekly earnings of nonagricultural workers have more than doubled since 1939, consumers' prices are only 69 per cent higher than in 1939. This rise in real wages and salaries, however, has been substantially offset, since income and social security taxes are now considerably heavier than they were before the war.

The composite indexes of hourly and weekly earnings used in this article and in the accompanying chart have recently been revised. Last fall, many of the series of basic data used in this bank's wage and salary indexes were revised by the Bureau of Labor Statistics. At the same time that the revisions were incorporated into this bank's indexes, the opportunity was taken for a thorough overhaul. The seasonal adjustment factors were revised wherever necessary, the problems of weighting were reviewed, and the methods of computing some of the series were improved. One new series—weekly earnings of bank and trust company employees—was included in the clerical and professional group. In most cases the indexes were recomputed from January 1947 to date, but for manufacturing wage earners and the composite indexes of which this series is a part, the revision extended back to September 1946.[1] Together with the previously published indexes, the series are continuous from 1938 to date. The revised indexes show substantially the same trends as the monthly data formerly published, but, in general, the new indexes are slightly higher than the old.

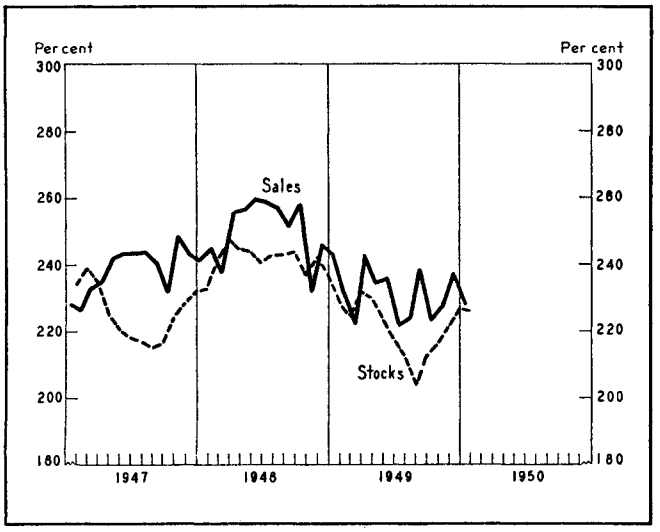
[1] Tabulations and descriptions of the revised indexes are available on request from the Domestic Research Division of this bank.

DEPARTMENT STORE TRADE

As had been the case in January, sales at Second District department stores during February were below trade expectations. Dollar volume dropped about 6 per cent below that of February 1949, and was well below the February 1948 level as well. There is even a strong likelihood, judging by preliminary information, that dollar sales failed to match those of February 1947. On a seasonally adjusted basis, it is estimated that February 1950 dollar volume touched one of the lowest levels in more than three years.

Stocks showed the usual seasonal drop during January as the stores liquidated merchandise left over from Christmas and "cleaned house" in preparation for taking physical inventory at the end of January. This bank's index of seasonally adjusted stocks, after four months of steady rise following the drastically curtailed stock position developed by the stores during the summer of 1949, leveled off only slightly below the index of seasonally adjusted sales. As the chart shows, during mid-1949 the stocks index had been considerably lower than the sales index. The aggregate value of stocks on hand on January 31 was one per cent below the level of a year previous. This small decline in dollar terms, considerably

Indexes of Department Store Sales and Stocks
Second Federal Reserve District*
(Adjusted for seasonal variation, 1935-39 average=100 per cent)



* Seasonal factors used to adjust sales have been revised, as noted on accompanying table.

less than the year-to-year decline in prices, indicates some expansion in real volume.

Reflecting a pickup in buying for delivery during the spring season, outstanding orders at the end of January were about one-third greater in dollar volume than at the first of the year. However, the rate of new ordering during January was 8 per cent below that of the same month in 1949 while incoming merchandise in January was almost up to the level of a year previous, so that the rise in outstanding orders was less sharp this January than last. Nevertheless, on this past January 31 outstanding orders were equal to those on the same date in 1949, owing to a more substantial level at the start of January 1950 than was the case the year before.

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

Item	1949			1950
	Jan.	Nov.	Dec.	Jan.
Sales (average daily), unadjusted	195*r*	293	401	183
Sales (average daily), seasonally adjusted*	244	227	237	229
Stocks, unadjusted	202*r*	255	207	200
Stocks, seasonally adjusted	229*r*	221	227	227

Revised.
* Seasonal adjustment factors for 1946-49 revised; available upon request from Research Department, Domestic Research Division.

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

Locality	Net sales		Stocks on hand Jan. 31, 1950
	Jan. 1950	Jan. through Dec. 1949	
Department stores, Second District	− 6	− 7	− 1
New York City	− 6	− 8	− 1
Northern New Jersey	− 5	− 6	+ 5
Newark	− 5	− 6	+ 7
Westchester County	− 6	+ 3	+11
Fairfield County	− 8	− 8	− 1
Bridgeport	− 8	− 8	− 3
Lower Hudson River Valley	− 7	− 4	− 6
Poughkeepsie	− 8	− 4	− 7
Upper Hudson River Valley	−12	− 5	− 8
Albany	−14	− 7	−17
Schenectady	−14	− 5	+ 1
Central New York State	− 3	− 6	− 3
Mohawk River Valley	− 3	− 8	− 5
Utica	− 2	− 7	− 7
Syracuse	− 3	− 5	− 2
Northern New York State	− 7	− 7	− 7
Southern New York State	−13	− 8	− 8
Binghamton	−17	− 9	− 8
Elmira	− 7	− 7	−11
Western New York State	− 5	− 5	− 1
Buffalo	− 5	− 4	− 3
Niagara Falls	− 4	− 4	+ 3
Rochester	− 6	− 8	+ 3
Apparel stores (chiefly New York City)	−10	− 9	− 7

Indexes of Business

Index	1949			1950
	Jan.	Nov.	Dec.	Jan.
Industrial production*, 1935-39 = 100 (*Board of Governors, Federal Reserve System*)	191	173	180	183*p*
Electric power output*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	262	256	267	276*p*
Ton-miles of railway freight*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	179	157	160*p*	
Sales of all retail stores*, 1935-39 = 100 (*Department of Commerce*)	329	330*r*	326	337*p*
Factory employment				
United States, 1939 = 100 (*Bureau of Labor Statistics*)	149	138*r*	141	140*p*
New York State, 1935-39 = 100 (*NYS Div. of Placement and Unemp. Ins.*)	120	115*p*	115*p*	113*p*
Factory payrolls				
United States, 1939 = 100 (*Bureau of Labor Statistics*)	346	316*r*	332*p*	330*e*
New York State, 1935-39 = 100 (*NYS Div. of Placement and Unemp. Ins.*)	288	269*p*	275*p*	270*p*
Personal income*, 1935-39 = 100 (*Department of Commerce*)	313	305	308*p*	
Composite index of wages and salaries*‡, 1939 = 100 (*Federal Reserve Bank of New York*)	198	202	203*p*	
Consumers' prices, 1935-39 = 100 (*Bureau of Labor Statistics*)	171	169	168	167
Velocity of demand deposits*#, 1935-39 = 100 (*Federal Reserve Bank of New York*)				
New York City	99	99	98	96
Outside New York City	89	86	84	87

* Adjusted for seasonal variation. *p* Preliminary. *r* Revised.
e Estimated by the Board of Governors of the Federal Reserve System.
‡ 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. This series has been recently revised back to September 1946; see descriptive article in this *Review*.
\# Seasonal adjustment factors for 1946-49 revised; available upon request from Research Department, Financial Statistics Division.

NATIONAL SUMMARY OF BUSINESS CONDITIONS

(Summarized by the Board of Governors of the Federal Reserve System, March 1, 1950)

INDUSTRIAL output increased somewhat further in January but was reduced by work stoppages in the early part of February. Construction activity was maintained at very high levels for this time of year. Personal incomes were supplemented by large payments of insurance dividends to veterans. Value of department store sales was close to last year's level and sales of automobiles were considerably larger. Prices generally remained stable.

INDUSTRIAL PRODUCTION

The Board's seasonally adjusted index of industrial production rose 3 points in January to 183 per cent of the 1935-39 average—the highest level since March 1949. In February, industrial output has apparently declined about 5 points, largely as a result of work stoppages in the coal and automobile industries.

Production of durable goods increased 3 per cent in January reflecting a large expansion in output of automobiles and smaller gains in nonferrous metals and iron and steel. Following model changeovers, automobile production by mid-January regained the record rate of last fall. Beginning January 25, however, auto assembly operations were reduced about one fifth by a labor dispute at the plants of a major producer. Output at steel mills increased to 95 per cent of capacity in mid-January but subsequently decreased as a result of coal shortages. For the month of February ingot production was scheduled at about 89 per cent of capacity but during the week beginning February 27 it dropped sharply to 74 per cent. Lumber production declined in January from the exceptionally high December level.

Output of nondurable goods in January was maintained at earlier high levels. There were small increases in cotton consumption, rayon deliveries, paper and paperboard production, and chemicals output. Production of most other nondurable goods showed small declines or little change from the level of the preceding month.

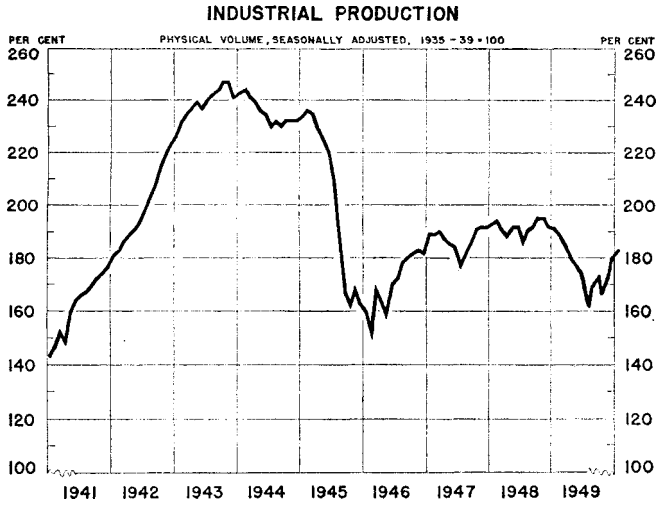
Minerals production showed a slight decline in January and in February was curtailed sharply further, as a result of work stoppages at coal mines. Output of petroleum showed little change, while metals production increased.

EMPLOYMENT

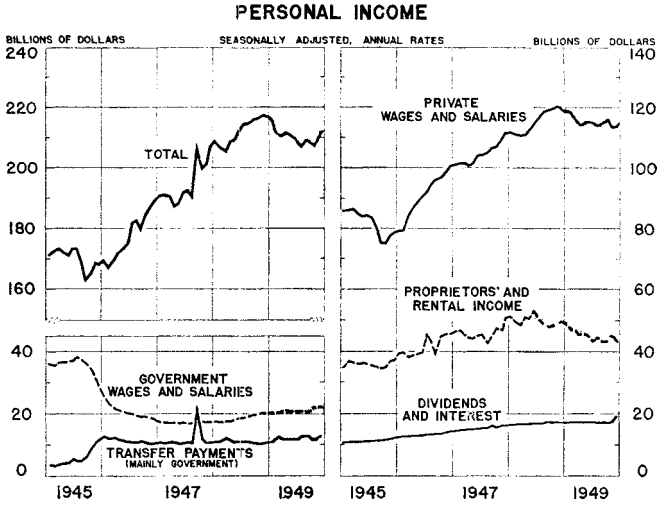
Employment in nonagricultural establishments, seasonally adjusted, was little changed in January as a sharp drop in employment at coal mines was more than offset by increases in construction and in plants manufacturing durable goods. Employment in most other lines showed little change. Unemployment rose to 4.5 million persons in January, up 1.8 million from January 1949.

CONSTRUCTION

Value of construction contract awards declined seasonally in January but was more than one-half larger than a year earlier. The number of new residential units started in January was estimated by the Bureau of Labor Statistics to be 80,000 as compared with 79,000 units in December and 50,000 in January 1949.



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



Department of Commerce estimates. Monthly figures; latest shown are for December. Total includes "other labor income", such as employer contributions to private pension funds, not shown separately. Employee contributions for social insurance are included in wage and salary disbursements but not in total.

Distribution

Value of department store sales showed somewhat more than the usual seasonal decline in January and the Board's adjusted index was at 282 per cent of the 1935-39 average as compared with 293 in December and 276 in November. Sales during the three weeks ended February 18 were maintained at the same level as in the corresponding period last year. Sales of apparel at department stores remained below year-ago levels while sales of most durable goods were in greater volume. Sales of new automobiles were exceptionally large for this season of the year. The payment of insurance dividends to veterans beginning the middle of January is providing an important supplement to personal income at this time, tending to increase retail sales.

Shipments of railroad revenue freight rose somewhat in January, after allowance for seasonal changes, as increased loadings of most manufactured goods and ore more than offset declines in grain and forest products. Freight carloadings dropped sharply in early February, reflecting mainly the curtailment of coal and coke production.

Commodity Prices

The general wholesale price index rose somewhat from mid-January to the third week of February, reflecting largely increases in prices of cotton, hogs, and pork. These changes resulted in part from seasonal reductions in supplies. Prices of lumber and some other building materials also were advanced in this period. On the other hand, prices of some textile and chemical products and automobiles were reduced.

The average level of consumer prices declined further by 0.4 per cent from December to January owing to small decreases in retail prices of foods and most other groups of goods and services, except fuels and rent which continued to increase.

Bank Credit

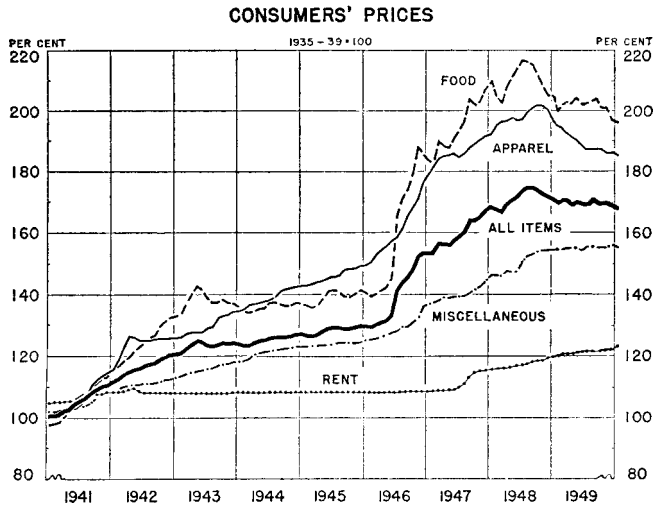
During January and the first half of February holdings of Government securities at member banks in leading cities and Federal Reserve Banks combined declined by about 1.5 billion, indicating substantial purchases by nonbank investors. Federal Reserve Banks sold large amounts of Treasury bills and a substantial volume of bonds in response to a strong market demand, but purchased certificates and notes. Reporting member banks purchased bonds, while reducing their holdings of shorter-term securities.

Bank holdings of corporate and municipal securities increased further in January and February, and real estate loans expanded moderately. Business loans did not show the usual seasonal decline. Adjusted demand deposits at reporting banks declined substantially, while Treasury deposits increased.

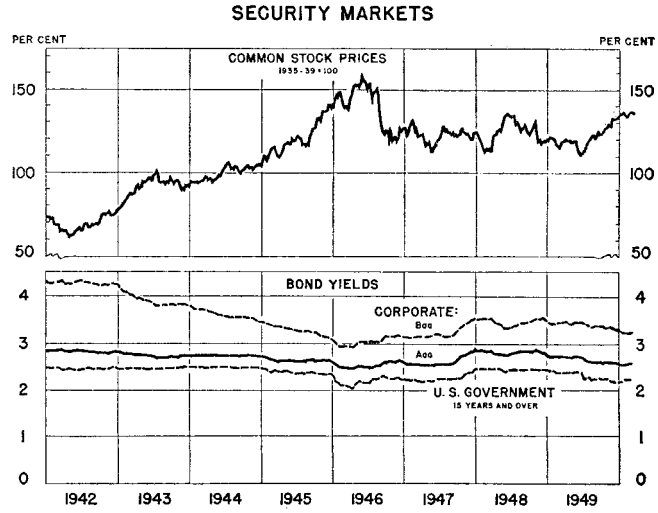
Member bank reserves showed little net change from late December through the first three weeks of February. Decreases in money in circulation and in Treasury deposits supplied reserves, which were largely absorbed by the decline in Federal Reserve holdings of Government securities.

Security Markets

Common stock prices declined slightly after the first week of February when they had reached a new high level since 1946. Corporate bond prices remained stable while long-term Treasury issues showed a small further decline. Yields on short-term Treasury securities continued to increase. The Treasury announced the offering of a 1½ per cent, five-year note issue in exchange for bonds called for redemption on March 15 and notes maturing on April 1; also 1¼ per cent Treasury notes maturing on July 1, 1951 were offered in exchange for certificates maturing March 1, and April 1.



Bureau of Labor Statistics' indexes. "All items" includes housefurnishings, fuel, and miscellaneous groups not shown separately. Midmonth figures; latest shown are for January.



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 February 18.