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MONEY MARKET IN OCTOBER

Money market conditions during October ranged from quite tight to very easy, as the efforts of the Federal Reserve System to keep a tight rein on the supply of reserve funds available to the banking system, as a means of discouraging unnecessary credit expansion, were offset temporarily at intervals by technical influences beyond the control of the Reserve System. On the whole, however, the banks handled any additional funds that became available to them with circumspection, and the Reserve System appeared to be having some success in achieving its objectives.

A further decline occurred in prices of short-term Government obligations, and was accompanied by additional declines in prices of Government bonds, especially the bank-eligible issues, during the first three weeks of October, but in the latter part of the month prices of such bonds became steadier. Prices of partially tax-exempt issues, on the other hand, showed greater stability early in the month, apparently reflecting the expectation of early action to increase tax rates further, but had an accelerated decline later on.

During the month the Federal Reserve System supplemented its actions designed to restrain general credit expansion by a further tightening of restrictions on consumer credit, and by the issuance, in cooperation with the Housing and Home Finance Agency and the Veterans' Administration, of a new regulation designed to restrict extensions of mortgage credit. As these measures were taken around the middle of the month, it is too early to appraise their effects in terms of the regularly reported credit statistics, but the effects are expected to be substantial. The growth in business loans of reporting member banks continued during the first three weeks of October, but at a considerably reduced rate. Aside from further borrowings by finance companies, the growth in business loans appeared to have been largely a result of seasonal commodity financing.

The commercial banks' security operations during the past month were apparently directed toward the objective of improving the liquidity of their security positions, partly in anticipation of a possible increase in legal reserve requirements and partly reflecting uncertainty as to the future course of interest rates. An increase in the yields on short-term Treasury notes was interpreted in the market as a forerunner of further increases in short-term money rates, and for a short time led to an acceleration of bank sales of such issues. At the same time, the banks tended to invest idle funds in Treasury bills, which they purchased in substantial amounts following a temporary large increase in their excess reserves in the third week of the month.

MEMBER BANK RESERVE POSITIONS

With the passing of the quarterly tax period in the latter part of September, pressure on member bank reserve positions lightened, and for several days after the first of October money market conditions were very easy as a result of substantial net disbursements by the Treasury in connection with the redemption of maturing securities that were not exchanged for new Treasury notes. During the remainder of the first half of the month, however, member banks lost reserve funds through seasonal currency demands, payments to foreign accounts at the Reserve Banks, and other factors, and the money market turned decidedly firmer. New York City banks were subject not only to these influences, but also to a substantial outflow of funds to other parts of the country—first of business funds and then of banking funds. There were indications that out-of-town banks were building up their excess reserves in order to be prepared for a rumored imminent increase in legal reserve requirements. These banks sold Treasury bills and other short-term securities in New York and apparently transferred the proceeds to their accounts in local Reserve Banks.

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Thus, most of the pressure was concentrated on the reserve positions of the New York City banks. In making the necessary adjustments in their reserve positions, the City banks sold substantial amounts of short-term Treasury securities, largely Treasury bills, and drew down their excess reserves. The surplus balances of all other member banks rose about 240 million dollars in the two-week period ended October 11.

In the following week, the banks gained a large volume of reserves, primarily through an exceptionally large increase in the Federal Reserve float, and the money market became very easy. The unusual magnitude of the float apparently was due to transportation delays and to the occurrence of the Columbus Day holiday and the mid-month at the end of a week, which delayed the processing of checks. At first the banks held the added funds at their disposal idle in their reserve accounts, and excess reserves rose above 1.3 billion dollars for all member banks. When the rumored increase in reserve requirements failed to occur as early as had been feared, however, banks in other parts of the country shifted part of their idle funds back to New York and used some of them to purchase Treasury bills. The resultant ease in the New York money market also enabled the City banks to acquire Treasury bills. Most of the banks' purchases came indirectly out of the Reserve Banks' bill portfolio, which was reduced by more than 500 million dollars in the two weeks ended October 25. At the end of this period the abnormal float was reduced rapidly, the excess reserves of the central reserve New York City banks fell 245 million dollars, and those of all member banks fell 590 million, in the week of October 19 to 25, and a rapid change to tighter money market conditions followed.

In the remaining days of the month, moderate pressures were exerted on member bank reserve positions as a result of a month-end rise in currency in circulation, a further decline in float, and net receipts into Treasury accounts with the Reserve Banks.

Government Security Market

Under the weight of demand for securities of the shortest maturities a wider spread developed in October between yields on Treasury bills and short-term Treasury certificates and yields on securities maturing in one year or more. The demand for Treasury bills from corporations investing cash balances, and from other nonbank investors, was active during most of the month. During the first half of October, banks in need of reserves sold a substantial volume of bills, all of which were taken by nonbank investors. Subsequently, with the easing of reserve positions and reflecting the desire to maintain maximum liquidity in their portfolios as a precaution against higher legal reserve requirements or higher interest rates, the banks made substantial net purchases of Treasury bills. Yields on the new bill issues declined from 1.337 per cent for the new issues dated October 13 and 19 to 1.316 per cent for the issue of October 26, and yields on outstanding bills declined even further, while yields on securities maturing in about one year approached 1½ per cent. A large part of the banks' demands for bills was filled from sales out of the Reserve Banks' holdings, thus withdrawing funds from the market.

Short-term Treasury notes maturing through 1951 were offered by the banks during the first part of the month, at about the same time they were selling Treasury bills. These offerings met with little market demand and ultimately found their way into the System's portfolio. Continued sales of notes around the middle of the month by some banks in need of funds, even though reserve positions in the aggregate had turned easier, met with declining bids, and transactions were effected on a rising yield basis. However, as the yield on these issues approached 1½ per cent, selling subsided. With the widening of the differential between the yields on notes and bills, making the former more attractive to hold, banks and others made moderate purchases on a rising scale of yields. Net purchases of Treasury notes by the System rose from 40 million dollars in the week ended October 11 to about 100 million dollars in the following week, but declined to 19 million in the week of October 25.

Prices of Government bonds moved downward in sympathy with the rise in yields on short-term Treasury notes. In keeping with their preference for liquidity, the banks came into the market for only small amounts of bank-eligible bonds. Prices were marked down rather sizably by dealers on small offerings, and losses of about ⅝ of a point occurred in the three longest maturities over the month as a whole. Ineligible bonds also were marked down in price as life insurance companies, savings banks, and other institutional investors continued to sell them in order to meet other commitments for funds. Some selling of the ineligible bonds, moreover, was reported to have originated out of decisions to purchase F and G Savings bonds under the Treasury's special offer during the first ten days of the month. The two longest maturing issues, the June and December 1967-72's, remained unchanged in price, but quotations on the other issues declined by from 7/32 to 15/32. Purchases of Treasury bonds by the Reserve Banks amounted to 285 million dollars in the four weeks ended October 25, but, together with purchases of Treasury notes, were more than offset by sales of Treasury bills, so that total Reserve Bank holdings declined 124 million dollars.

Member Bank Loan Expansion

The rate of expansion in loans of weekly reporting member banks diminished considerably during the past month. The increase in total loans of those banks during the three weeks ended October 18 was less than one third as large as in the preceding three weeks. The reduced rate of expansion is attributable partly to a decline in loans to brokers and dealers, especially on Government securities, but a factor of greater importance was a slowing of the growth in business loans. In the week ended October 18, the business loans of New York City member banks showed an actual reduction because of loan repayments by a utility company out of the proceeds of

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a new security issue. But other business loans of these banks increased much less than in September, and the total increase in the three weeks ended October 25 amounted to only 52 million dollars, compared with an increase of 261 million in the preceding three weeks. Business loans of other weekly reporting banks continued to expand rather rapidly in the two weeks ended October 11, but showed a smaller increase in the following week, and for the three weeks as a whole the increase amounted to 294 million, compared with 475 million in the three weeks ended September 27.

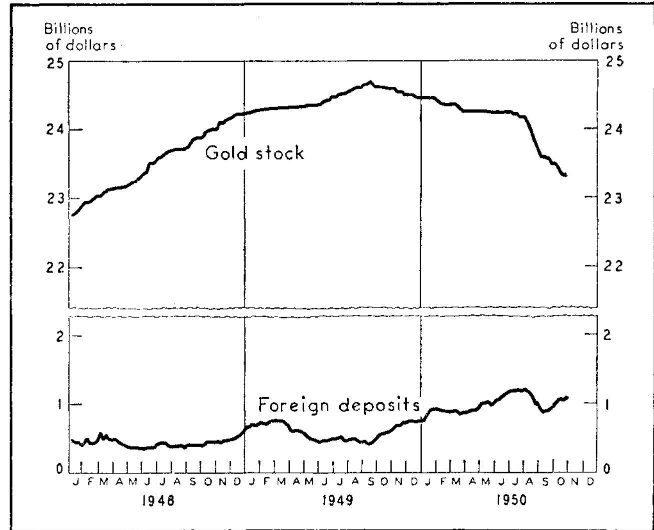
The rate of expansion of real estate and "all other" (including consumer) loans of the weekly reporting member banks also diminished, but not to the same extent. The continued expansion of real estate and "all other" loans may have been influenced by anticipation of the adoption of real estate credit restrictions and tighter consumer credit controls. Both of these anticipated developments became facts during the month with the issuance by the Federal Reserve Board and the Housing and Home Finance Agency of regulations relating to mortgage borrowing on new homes, and with the tightening of the Board's Regulation W relating to consumer credit. It is probable, however, that the volume of home mortgage financing will continue to grow in the next few months owing to the large volume of new housing started in the summer which has yet to be completed and financed and which is not covered by the new regulations. The influence of the tightened provisions of Regulation W should be felt more promptly.

Gold and Foreign Account Operations

The monetary gold stock of the United States declined 184 million dollars further in the four weeks ended October 25. This decrease, and the sizable decreases in August and September, reflected the acceleration of a development which started a little over a year ago, just after the devaluation of the pound sterling and of numerous other foreign currencies. On September 21, 1949 the gold stock of this country had reached an all-time peak of 24.7 billion dollars. Within 13 months, it declined by 1,401 million dollars.

Despite substantial Government aid to foreign countries, the United States monetary gold stock increased almost 4.7 billion dollars during the postwar years through September 1949. This large inflow of gold was the result of the huge world demand for American goods and services, the low level of production and exports in the war-devastated countries, and inflationary conditions or overvalued currencies in some countries. As a result of American financial aid to Europe and other areas, the gradual economic recovery in Europe, the expansion of American imports accompanying capacity industrial operations in the United States, growing foreign import restrictions against American goods, and other factors, the rate of growth in this country's monetary gold declined after 1947. The increase in the first nine months of 1949 was decidedly less than in the corresponding period of 1948, despite a decline in United States imports.

United States Gold Stock and Foreign Deposits in the Federal Reserve Banks, 1948-50*



* Wednesday dates; latest figures are for October 25, 1950.

The decrease in the United States gold stock since September 1949 reflects basically an improvement in the cash trade position of European and other countries with the United States to a point where, beginning with the third quarter of 1950, American imports of goods and services have exceeded the value of exports which other countries have had to pay for out of their own dollar earnings or balances (i.e., exports which were not financed through grants and credits of the United States Government). Since the start of the Korean war, this trend has become more pronounced as a result of our increasing imports and some movement of private capital to a few countries, notably Canada.

The acceleration of the decline in the gold stock in the past three months (over 800 million dollars, compared with about 550 million in the previous ten months), however, has reflected in part a more rapid conversion into gold of dollars acquired by foreign countries than in previous months, and has not involved proportionately large withdrawals of funds from the money market. In the earlier period, between September 1949 and the beginning of August this year, foreign authorities kept a larger part of the dollars that came into their possession in their accounts with the Federal Reserve Banks. Foreign deposits with the Reserve Banks in this period rose 774 million dollars and this rise, together with foreign purchases of gold from the Treasury of over 550 million, resulted in a drain of over 1.3 billion dollars on member bank reserves.

During the past three months, on the other hand, foreign gold purchases were partly financed with funds on deposit with the Reserve Banks. Thus, of the decrease of 846 million dollars in the United States gold stock between August 2 and October 25 of this year, 137 million dollars reflected foreign gold purchases financed by a decrease in foreign deposit accounts with the Reserve Banks, and the net drain on the money market amounted to 709 million dollars.

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In addition to building up their deposits in the United States and purchasing gold, foreign countries have returned a part of their dollar accumulations to the money market by investing them in Government securities, mainly Treasury bills.

PRIVATE "DEFICIT FINANCING" AND INFLATION

In recent years, inflationary pressures have prevailed intermittently and in varying degree in the United States. At the end of the war, economic conditions were ripe for inflation defined as a rise in the general level of prices stemming from an increase in expenditures not accompanied by a corresponding expansion of the flow of goods available for purchase. Wartime-deferred demands of business, consumers, State and local governments, foreign countries, and others for great quantities of all sorts of goods and services could be satisfied only after several years of capacity output. Backed by large backlogs of liquid reserves and augmented by credit easily obtainable, these demands pressed strongly on the market. A sharp rise in commodity prices resulted.

Following their virtual cessation in 1949, inflationary pressures began to reappear early in 1950, and since June they have been intensified as a result of the public's reaction to the Korean war and to the adoption by this country of a large rearmament program. Once again, therefore, the attention of the business community, of government officials, and of the general public is focussed on the problem of combating inflation.

In the discussion of the problem, Treasury deficit spending has been placed in the forefront among the factors making for inflation, and higher Federal taxes have therefore been one of the major solutions proposed. While the prescription of a balanced Federal budget is certainly sound, it deals directly with only one of the possible sources of inflationary developments. When the economy is operating at or near capacity, deficit spending may well be the prime cause of inflation, especially if the deficit is financed through the banking system. But deficit spending by the Federal Government is only one of the possible causes of inflation. Expenditures in excess of current income by business, consumers, or State and local governments or by any other major economic group are, if financed through bank credit, just as inflationary as bank-financed Government deficits. The emphasis on Treasury deficits as a cause of inflation is no doubt associated with the fact that historically major periods of inflation in nearly all countries have been connected with Government deficits, with the excessive issuance of currency, or with substantial Government borrowing from the commercial or central banks. The current discussion of the impact of the remobilization of American economic and military resources frequently proceeds in terms inherited in large part from the public discussion of World War II financing.

The Government-generated process of inflation in wartime has been described frequently. Armament expenditures absorb materials and manpower in activities which do not satisfy the normal wants of individuals or add to the current standard of living. If an amount equivalent to the income generated by military spending is promptly recaptured through taxes or through borrowing from nonbank investors, the funds available for civilian goods are held within existing supplies and the general price level is held reasonably stable. When a Treasury deficit arises and business and individuals are not willing to reduce their spending and to lend part of their current incomes to the Government, Government financing through the banking system becomes necessary. The resulting expansion of bank credit increases the demand for scarce supplies and, since the volume of goods available to the civilian economy is limited, results in rising commodity prices.

The inflationary process is by no means peculiar to wartime periods. Peacetime Government deficits financed through the banking system during a period of capacity operations tend to have the same inflationary effects as wartime deficits. Nor, as already indicated, is Government finance the only potential source of inflation. Expenditures by any important elements in the private economy, when financed through the banks, have been the source of inflation in the past as well as in recent years. Spending by any one group in the economy in excess of its income is normally financed through tapping the current savings of other groups. If the latter are not willing to keep their aggregate consumption below their current income and to turn over the difference to the group that incurs a deficit, the spenders will seek to borrow from the banks. At a time when the total volume of goods available is restricted through limitations of capacity or for some other reason, the resulting expansion of bank credit, if permitted, merely leads to an increase in prices and thus to inflation.

Excessive private expenditures, rather than Government deficit spending, were the major generating force behind the most recent rise in commodity prices. As a matter of fact, this has been true for the postwar period as a whole. Over the postwar years, the net profits of business enterprise after taxes and dividends were not sufficient to finance all business expenditures for plant and equipment expansion and inventory accumulation. Business spending on plant and equipment and inventories, like Government spending for military purposes, absorbs materials and manpower in activities which do not immediately yield goods to satisfy the consumer demand which is supported by income generated by such expenditures. Since depreciation allowances and current retained earnings could finance only a part of business expenditures for new production facilities, the other part had to be financed through the use of accumulated business savings (mainly through the liquidation of Government security holdings), through the sale of shares in the capital markets, and through borrowing. However, individuals were not willing to reduce their consumption sufficiently to meet all business needs for funds, by purchasing from business concerns Government securities, new

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corporate issues, or other forms of investment. The banking system (including the Federal Reserve Banks indirectly) was, therefore, called upon to meet the residual demand for funds. In other words, business was able to finance only a part of its deficit spending through borrowing the savings of nonbank investors. The incomes generated by business capital expenditures consequently tended to augment the demand for consumer goods at the same time that capital expenditures were limiting the supply of goods available for consumers. The volume of such expenditures fluctuated during the postwar period, and the inflationary pressures arising from this source likewise varied.

Deficit spending of State and local governments, to the extent that it was not financed through nonbank investor purchases of new municipal security issues offered in the capital markets, also acted in the same direction. Purchases of merchandise in this country by foreigners, to the extent that they were not offset by sales of goods to the United States, by U. S. Government grants and credits (financed by taxpayers and nonbank purchasers of Government securities), or by private grants and nonbank credits, also tended to absorb goods that otherwise would have been available for domestic use. To the degree that such purchases were financed through shipments of gold to the United States, they not only augmented the funds available in this country for the purchase of a given amount of goods but also increased the banks' capacity to make loans and to add to their investments.

Under such circumstances, inflation could have been avoided only if the general body of American consumers had been ready to limit its current expenditures correspondingly. This consumers were not ready to do after several years of wartime shortages. On the contrary, consumers have made, since the end of the war, substantial deficit expenditures for new housing and durable goods. However, the aggregate savings of all consumers exceeded the substantial deficit spending of some groups of consumers. In other words, the combined net savings of all consumers exceeded the net increase in the mortgage and consumer indebtedness and the liquidation of Government securities of those who spent in excess of their current incomes.

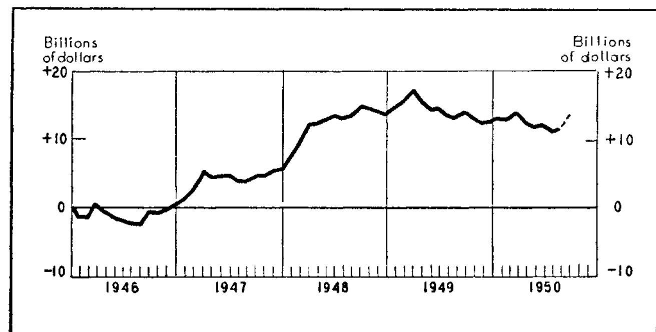
Personal saving, however, was not sufficiently large to meet the postwar deficit spending in the United States of business, State and local governments, and foreigners. Demands for bank credit have been consequently very heavy ever since the end of the war, with Government securities becoming an important vehicle of bank credit expansion. Institutional investors, finding that the demands for their resources exceeded the net increase in savings deposited with them by individuals, sold Government securities to the banking system, while business and consumers also liquidated or redeemed Governments in order to enlarge their expenditures.

The expansion of bank credit enabled all groups in the economy to bid for a limited (although growing) volume of supplies. The result of the heavy deficit expenditures of the economy was a sharp rise in commodity prices. By means of this price rise, the market "rationed" goods and services to receivers of current incomes, who frequently found themselves unable to make purchases freely out of their income at stable prices.

Rather than a source of inflationary pressures, Federal Government operations in most of the postwar period have been a major anti-inflation force. As shown in the accompanying chart, Government transactions have resulted in a net cash surplus during most of the postwar period. While the Treasury's cash operating income and outgo were approximately in balance during the calendar year 1946, the Treasury was able to retire (out of substantial cash balances consisting mainly of the proceeds of the Victory Loan drive toward the end of 1945) large amounts of called and maturing obliga-

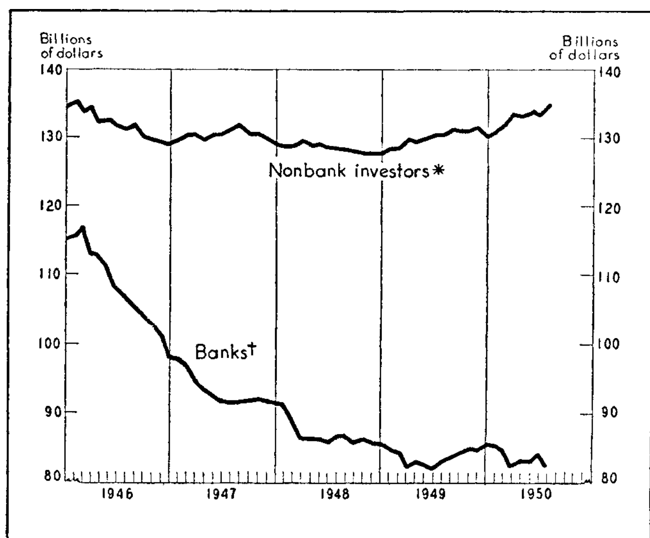
U. S. Government Net Cash Operating Income or Outgo 1946-September 1950*

(Cumulated monthly from December 31, 1945)



* (+) indicates net income; (—) net outgo.
Source: U. S. Treasury Department; September 1950 estimated by the Federal Reserve Bank of New York.

Ownership of the Interest-Bearing Public Debt December 31, 1945-July 31, 1950



* Excludes holdings of Government agencies and trust funds.
† Federal Reserve and commercial banks.
Source: U. S. Treasury Department.

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tions held by the banking system and others. In the succeeding period through March 1949, the Treasury was able to apply approximately 17 billion dollars of net cash receipts toward debt retirement and, by redeeming Government securities held by the Federal Reserve System, to bring pressure on the commercial banks' reserves. Although Government disbursements have exceeded receipts since the first quarter of last year, most of the resultant increase in the public debt has been financed by private saving, i.e., has been borrowed from nonbank investors, as shown in the lower chart.

In fact, in the period since the start of the war in Korea, Government receipts have exceeded disbursements, and the accentuated inflationary pressures have clearly been the direct result of accelerated private spending, much of it financed by credit. It is true, of course, that such spending has been stimulated by fears of later shortages of civilian goods as a result of the national defense program, and to some extent by fears of further inflationary price advances growing out of Government deficit financing.

Looking forward, it is obvious that either large-scale economies in Federal nonmilitary expenditure or much higher taxes than those recently enacted by Congress will be necessary if the cash outlays, augmented by large appropriations for the financing of rearmament, are to be balanced by receipts. If neither the economies nor the additional taxes are forthcoming, financing through sales of securities entirely to nonbank investors will be difficult because, in the absence of rationing and direct price and production controls, peacetime rearmament expenditures are likely to be accompanied by deficit spending by business firms and others. Under the present policy of the Government, it is the task of the monetary authorities to combat such deficit spending through the use of general and specific credit controls.

RESTRICTION OF RESIDENTIAL REAL ESTATE CREDIT

On October 10, the Board of Governors of the Federal Reserve System issued Regulation X, which restricts the granting of credit on new residential construction, other than loans insured, guaranteed, or made by Government agencies.[1] Similar restrictions on Government-aided residential financing were announced at the same time by the Administrator of the Housing and Home Finance Agency and by the Veterans' Administrator. The restrictions on both types of loans became effective October 12.

The new regulations were issued under authority of the Defense Production Act of 1950 and the President's Executive Order No. 10161 of September 9, 1950. They are designed to lessen inflationary pressures by reducing the current record volume of residential construction and the further expansion of mortgage credit. A gradual reduction in the volume of residential construction will make materials and labor available for the defense program as that program gains momentum.

The goal in the field of residential construction credit control is to cut the number of new housing units produced in 1951 about one-third below the current record level, or to between 800,000 and 850,000. Both the Chairman of the Board of Governors of the Federal Reserve System and the Administrator of the Housing and Home Finance Agency have signified their intention of keeping the situation under close review to determine whether developments in the field of production and credit make later modification of this goal necessary.

The new regulations apply only to loans on one and two-family houses (including loans to finance additions and improvements, where the loan amount is more than $2,500), but they govern credits extended to finance construction as well as credits granted for the purchase of completed new homes. They do not apply to the financing of existing residential property where a conventional (non-Government-aided) mortgage is employed. Neither are they applicable to conventional loans on construction begun before noon on August 3 or to loan commitments made prior to October 12. The financing of existing residential properties using Government guaranteed or insured mortgages, however, is subject to the new regulations. Limitations on the granting of construction credit on multiple-family projects and nonresidential properties and restrictions on the granting of other types of real estate credit are expected to follow as soon as the terms of control can be worked out.

Virtually all future loans on new construction of one and two-family houses will be affected by the regulations announced October 10, which require down payments ranging from 10 per cent for homes priced at $5,000 or less to 50 per cent for those priced at $24,250 or over. (In the case of veterans, down payments may be lower by 5 or 10 percentage points.) Maximum maturities, as well as minimum amortization requirements, are specified. Thus, loans are limited to a maximum term of 20 years, except that loans on properties having a value (as defined in the regulations) of $7,000 or less may be made under a contract providing for complete amortization in 25 years. However, loans on properties valued in excess of $7,000 and amortized at a minimum annual rate of 5 per cent of the original amount of the loan may be exempt from further amortization when the outstanding balance has been reduced to 50 per cent (or less) of the value of the property as of the time the credit was granted.

In determining the maximum amount that can be loaned, lenders must take into account all credit previously granted in connection with the property and still outstanding. Minimum down payments on new residential construction must be made from the borrower's own funds, and not from the proceeds of supplemental mortgages or personal loans.

[1] Inquiries concerning Regulation X and requests for copies of the Regulation should be directed to the Real Estate Credit Department of this bank or (in branch territory) to the Buffalo Branch.

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THE 1950 HOUSING BOOM

This country has been experiencing a housing boom of unprecedented proportions. Whatever the effect of the recent restrictions on mortgage credit (described in the article "Restriction of Residential Real Estate Credit"), the number of new homes started in 1950 is certain to set an all-time record. During the first nine months alone, more than 1,100,000 nonfarm dwelling units were started, compared with the full-year record of 1,025,100 set in 1949, and the 937,000 units started in 1925 at the peak of the housing boom of the twenties. In each of the nine months, the number of homes started has exceeded the number in comparable months of all previous years by a considerable margin. The average gain during the first nine months of this year over the comparable 1949 period has been nearly 50 per cent. It seems likely that, for the year as a whole, the number of new homes started will total approximately 1,400,000.

In dollar volume, too, 1950 will be a record-breaking year. Private nonfarm residential construction expenditures for the first nine months of 1950 total 9.1 billion dollars, compared with 8.3 billion in the entire year 1949 and the record of 8.6 billion dollars in 1948. Part of the increase between 1949 and 1950 is accounted for by the rise in construction costs, but by far the larger share reflects the increase in the physical volume of housing construction.

The boom in home building has in fact been under way since the end of World War II. To a large extent it reflects the lag in new housing during the depression of the thirties and the restrictions placed on construction during the war. At the same time housing demand has been accentuated by a sharp increase in marriages and in the birth rate during the war and postwar periods and by the generally high level of postwar incomes and the sizable savings which many families have accumulated. Thus a considerable deficit in the supply of housing has existed since the end of the war. Moreover, the Government has encouraged home ownership through the promotion of easy financing. Government insured or guaranteed mortgages made it possible, prior to July 1950, for families to buy houses by means of low down payments (in some cases even without down payments), and to amortize the cost at lower interest rates and over longer periods than had previously been customary. Rental housing was encouraged, too, but the bulk of postwar construction has been concentrated in single-family homes.

Despite the construction of about three and a half million nonfarm dwellings in the postwar period through the end of 1949 and the availability of perhaps a million and a half more in the form of temporary units, the conversion of existing structures, and trailers, there was still considerable unfilled demand at the beginning of 1950. Both the Federal Reserve *Survey of Consumer Finances* and an analysis by the U. S. Department of Commerce indicated at that time that the market for new homes was still far from saturated.

In the spring of 1950, before the outbreak of hostilities in Korea, the number of new dwelling units started reached record-breaking proportions. To some extent, the increase in demand received its impetus from families who had previously held back from buying homes at inflated postwar prices. However, when the 1949 recession failed to bring any sizable reduction in prices of new houses, these families came into the market. The Korean war and the announcement of a long-term defense program by the United States sharply accentuated this buying rush. Many prospective home owners feared increased prices, while others anticipated shortages of materials and restrictions on construction similar to those in World War II.

The shortages of materials soon appeared, caused in part by the unprecedented number of homes undergoing construction. But, to a large extent, builders and suppliers helped to create the very shortages they feared by rushing to buy ahead. When builders attempted to stock up on all the potentially scarce items they would need to complete projects barely under way, factories which normally could have made delivery over a period of several months found themselves unable to meet the sudden surge in demand. Prices rose, and in some cases "gray" markets appeared. For certain items, such as steel, the competition from other industrial users stretched the available supplies even thinner.

The construction industry was one of the first to become subject to regulation as a result of the Korean crisis. President Truman on July 18 requested restriction of housing credit "to conserve building materials which may be needed for national defense and to curb inflation". The Federal Housing Commissioner and the Veterans' Administrator carried out this directive, chiefly through increasing down payment requirements. Because this action coincided with a rush of new and eager customers into the market, the impact of the restrictions was not readily ascertainable. Sales still boomed, but it became evident that many marginal buyers had been forced out of the market. One large builder in this area reported that 25 per cent of his nonveteran customers canceled their applications when the new requirements increased their required down payments by $640.

The real estate credit restrictions announced jointly on October 10 by the Federal Reserve System and other home financing agencies were far more stringent in their provisions. The administering agencies announced that their goal was to cut 1951 housing starts to not more than 800,000 to 850,000 new units, a reduction of at least one third from current levels. The initial reaction of some builders was that the cut caused by the new regulations might be even sharper. In any case, the effectiveness of the restrictions will not be fully reflected in the number of new starts or in the volume of activity for some months, because a very large volume of financing commitments under the old terms is still outstanding, and work is progressing on many recently started projects. The actual impact of mortgage credit curbs will be further obscured by the influence

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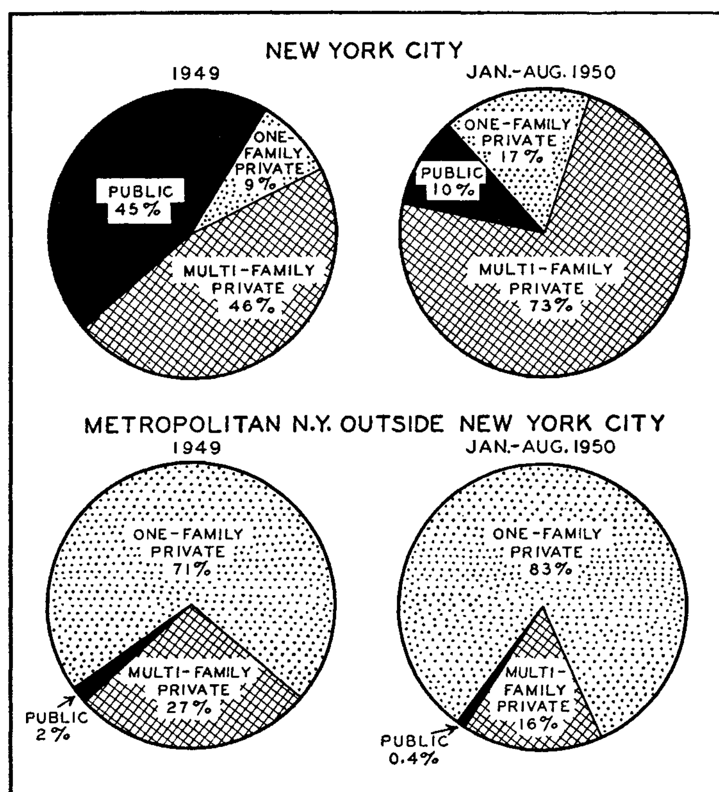
of the seasonal decline in new starts which ordinarily occurs in the last third of the year, by the effects of the building materials situation, and by the expectation, held in some quarters even before the Korean situation developed, that some decline in homebuilding activity would be likely in 1951 as the market in many areas would approach saturation at prevailing prices. One consequence of the announcement of the regulations and the general anticipation of a substantially lower rate of activity next year has been the more ready availability of some building materials, in some cases at lower prices, as hoarded supplies have come into the market.

The latest available data on construction activity, covering the month of September, bear out the expectation that the dollar volume of work on housing will continue at a high level for some time after the number of new dwelling units started begins to drop. The value of residential construction put into place in September set a new all-time record of 1.3 billion dollars. The number of new homes started in September, however, dropped 18 per cent to 115,000, and the dollar volume of residential construction contracts dropped even more. This drop largely reflected seasonal factors and the extraordinarily high level of starts in the preceding months. Despite a decline of 26,000 units from August, September "starts" were still the highest for any September on record. In each of the four months, May through August, more than 140,000 dwellings had been started, whereas prior to 1950 no month on record had even as many as 105,000 "starts". The completion of this record-breaking number of new dwellings will keep builders extremely active the rest of this year. The dollar volume of construction expenditures will be further swelled in many areas by the increased prices of many building materials and by recent wage increases for construction workers. The rapid climb in building costs is illustrated by the E. H. Boeckh index of residential building costs in 20 cities, which in September 1950 was 12 per cent higher than in September 1949 and 8 per cent greater than in April 1950.

New Permanent Dwelling Units Started in New York City and in the Metropolitan Area Outside New York City Percentage Distribution by Type, 1949 and Jan.-Aug. 1950



Source: U. S. Bureau of Labor Statistics.

The New York metropolitan area has felt the effects of the 1950 housing boom, but perhaps not so much as some other areas, since homebuilding in 1949 was already at a very high level in this region. The number of new dwelling units started in the first eight months of 1950 was one-third greater than in the corresponding months of 1949. Some of the major characteristics of the housing market in this area are indicated by the chart. In New York City, as might be expected, the number of single-family residences built is relatively unimportant. In 1949, over 90 per cent of the new dwelling units started in New York City were apartment houses or other multi-family dwellings. About half of these were built with public funds to provide homes for families of low or moderate income. The 19,660 public housing units started in New York City in 1949 were more than were begun that year in all the rest of the United States. However, as a result of a lag during the early part of the year, public housing accounts for a much lower percentage of all housing started in the City so far during 1950. During the third quarter of 1950, however, several new projects got under way and nearly 4,200 units of public housing were started. At least nine more projects are planned for next year, including some deferred from 1950 because of President Truman's request to limit public housing starts this year. Private apartment building was stimulated earlier this year by the rush to take advantage of the liberal financing provisions of Section 608 of the National Housing Act, and approximately the same number of apartment units were started in the first nine months of 1950 as in the entire year 1949. Activity was sustained even after Section 608 expired on March 1, 1950, because many commitments were still outstanding.

In the metropolitan area outside New York City, single-family homes dominate the housing picture, as in the rest of the country. The importance of public housing is negligible. Apartment house construction in the suburbs has lagged behind the 1949 rate so far this year and accounts for less than one sixth of the 60,900 suburban dwelling units started

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in the first eight months of 1950. The construction of single-family homes, particularly in the low and middle price brackets, has been booming. A total of 50,700 one-family homes had been started in the New York suburban area by the end of August, compared with 42,540 in all of 1949.

The New York metropolitan homebuilding industry has been geared to the sale of moderately priced homes under liberal financing terms. A survey made by the Bureau of Labor Statistics indicates that in the last six months of 1949 half of the single-family homes completed in the New York area sold for less than $10,000. Two thirds of all homes were bought by families with annual incomes of less than $5,000. No down payment was made by one fifth of the home buyers, and an additional one fourth made down payments of less than $1,000. Two thirds of the purchasers of houses priced under $10,000 made no down payment or paid less than $1,000, but among those who bought homes for $14,000 or more 80 per cent made down payments of at least $5,000.

On Long Island and in Northern New Jersey, large-scale builders, who depend upon assembly-line construction of large projects for efficient operation, have been particularly active. One of the largest of these builders has announced that he plans to cut his 1951 program to only half his 1950 output. This decision was probably affected as much by the prospects for building materials as by the effects of credit restrictions. Even before the recent regulations were issued, a number of builders were reported cutting down on their future plans because they were afraid that shortages of materials would catch them with a row of unfinished houses. Some builders were also forced to curtail plans because institutional lenders have been tightening up on their mortgage credit policies since midsummer. The full extent of the curtailment in building caused by all these factors will not become apparent, however, until the backlog of projects already under way is worked off.

NONFARM REAL ESTATE LENDING OF SECOND DISTRICT MEMBER BANKS

The record volume of new construction that has taken place since the end of World War II has been accompanied by an unprecedented increase in the volume of outstanding mortgage debt. The growth in mortgage debt has reflected not only the increase in the physical volume of building and the accompanying sharp postwar advances in labor and material costs, but also the additional debt incurred in the turnover of older buildings at advancing prices. Total nonfarm mortgage debt in the United States at the end of 1949 has been estimated by the Department of Commerce at 58.4 billion dollars, or 26.7 billion dollars (84 per cent) greater than the total outstanding at the close of 1945 and 20 billion dollars (52 per cent) above the volume outstanding during the prewar peak attained in 1930. The burden of carrying the current debt is relatively less than in prewar years, however, because of the even greater growth in incomes, the decline in interest rates, and the lengthening of periods of amortization.

Nonfarm mortgage loans of the commercial banks in the 1945-49 period grew twice as fast as those of all other lenders combined. Commercial bank holdings of this type rose from 4.2 billion dollars in 1945 to 10.7 billion in 1949, or by 155 per cent; all other lenders combined increased their nonfarm mortgage loans from 27.5 billion dollars to 47.7 billion in the same period, or by 73 per cent. Relative to total outstanding nonfarm mortgages of all lenders, commercial bank holdings equaled 18.3 per cent at the end of 1949 as compared with 13.2 per cent at the close of 1945. For the Second Federal Reserve District, statistics on mortgage holdings by type of lender are not available, but the growing participation in the field by commercial banks in this area is indicated by nonfarm mortgage recordings of $20,000 or less for the Second Federal Home Loan Bank District, comprising the entire States of New York and New Jersey. Commercial bank recordings in these two States were 14.4 per cent of those for all lenders in 1945 and 17.0 per cent in 1949, proportions differing only slightly from those applying to holdings of commercial banks nationally.

Among the individual Federal Reserve Districts, the greatest percentage gains in nonfarm mortgage holdings by member banks between 1945 and 1949 have occurred in the districts of Atlanta, Dallas, Kansas City, and San Francisco. The heavier increases in these four districts doubtless arose out of the larger housing needs accompanying a greater growth in industry and population than in other districts. The smallest postwar increases have occurred in the more settled districts of Boston, Chicago, Philadelphia, and Cleveland. In the New York District, the rise (155 per cent) has paralleled that occurring in the country as a whole, although the absolute increase of 800 million dollars was greater than that in any Reserve District but San Francisco.

During the first six months of 1950, nonfarm mortgage lending by commercial banks in the United States is estimated to have risen an additional 900 million dollars to 11.6 billion. Of this total, the loans extended by Reserve System members accounted for 9.0 billion, or 78 per cent. Between June 30 and the end of September, commercial bank nonfarm real estate lending continued to increase at an accelerated pace. The third-quarter increase in all commercial banks in the United States is estimated at 850 million dollars, of which 700 million was in member banks. In this District the rise in member bank nonfarm real estate credit equaled 170 million dollars during the first six months of 1950, while the June-September rise is estimated at 240 million dollars.

Residential construction has been the mainspring of the postwar building boom and of the nonfarm mortgage lending by member banks, both in the country as a whole and in the Second Federal Reserve District. On June 30, 1950 roughly five sixths of the nonfarm real estate loans of member banks

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were secured by residential property and only one sixth by business and other properties. However, business properties, particularly manufacturing plants, have generally been financed by recourse to the capital markets or by the reinvestment of earnings. Relative to total loans, residential real estate loans have assumed a place of considerable importance. As of June 30, 1950 they equaled one fifth of total member bank loans in the country and 12 per cent of the total in the Second District. In the central reserve New York City banks, residential real estate loans have always been overshadowed by the heavy volume of business and security loans and even today's sizable volume, 323 million, equals only 4 per cent of the City banks' aggregate loan portfolios. In the other member banks of the Second District, however, residential real estate loans represent no less than one third of all loans outstanding.

Recognizing the growing importance of such housing credit, the Federal Reserve System, in cooperation with the Comptroller of the Currency and the Federal Deposit Insurance Corporation, obtained new information as of June 30, 1950 concerning the kinds of residential loans held by commercial banks, the extent to which banks are directly financing residential construction, and the extent to which they are indirectly financing real estate by loans to other real estate lenders.

Table I shows the aggregate number and dollar volume of residential real estate loans held by the various-sized member banks in this District on June 30, 1950. It reveals that these banks had outstanding 211,300 residential real estate loans aggregating 1,289 million dollars. Permanent financing by the member banks in the form of residential mortgage holdings accounted for 72 per cent (925 million dollars) of the total dollar amount and 96 per cent (202,100) of the total number of such loans. Loans for the construction of residential real estate were relatively few in number, 7,600, and were mostly confined to portfolios of the larger banks; nevertheless, since they were individually large, they totaled one quarter of the dollar amount of all real estate loans, or 326 million dollars. Indirect financing of real estate by loans to other lenders such as savings and loan associations, mortgage companies, mortgage brokers, etc., was a minor factor in the over-all member bank real estate financing and accounted for only 38 million dollars (3 per cent of the dollar volume) and 1,400 individual loans (less than one per cent of the total number).

Although accounting for three fourths of the total dollar volume of residential construction loans of the District member banks, the large central reserve New York City banks did not engage in much permanent financing of residential property. Relatively, the large City banks have a much smaller volume of time deposits than the other Second District banks and thus they are inclined to place a smaller volume of available funds in long-term real estate mortgages. Also, because of their great resources, they are better able to handle large construction loans; the average amount of individual construction loans by the big City banks was nearly $350,000. These loans are principally rental housing loans insured under Title VI, Section 608, of the National Housing Act. They are carried by the banks for the duration of construction, usually 12 to 15 months, and bear a rate of 4 per cent. When a

Table I
Number and Dollar Amount of Residential Real Estate Loans by Different-Sized Member Banks in the Second Federal Reserve District on June 30, 1950
(Dollar amounts in thousands)

Type of loan	Number of loans						Dollar amount					
		Member banks outside New York City Deposit size:						Member banks outside New York City Deposit size:				
	New York City central reserve (25 banks)	Over $20 million (82 banks)	$5 to $20 million (267 banks)	$2 to $5 million (243 banks)	Under $2 million (148 banks)	Total Second District (765 banks)	New York City central reserve (25 banks)	Over $20 million (82 banks)	$5 to $20 million (267 banks)	$2 to $5 million (243 banks)	Under $2 million (148 banks)	Total Second District (765 banks)
I. Real estate loans secured by residential properties												
A. Secured by 1 to 4-family properties												
1. Insured by FHA	2,900	32,877	11,334	2,465	316	49,892	17,239	161.657	47,373	9,929	1,114	237,312
2. First lien insured or guaranteed by VA	441	16,858	19,212	7,386	1,759	45,656	2,952	102,919	108,025	34,822	6,416	255,134
3. Junior lien guaranteed by VA	639	6,963	1,028	506	27	9.163	832	10,076	1,798	717	34	13,457
4. Not insured or guaranteed by FHA or VA												
(a) Amortized	715	27,743	38,698	19,888	4,992	92,036	3,343	106,563	142,673	56,962	9,991	319,532
(b) Not amortized	28	411	1,175	843	486	2,943	343	1,241	3,246	1,776	748	7,354
B. Loans secured by 5 or more family properties												
1. Insured or guaranteed by FHA or VA	74	175	15	4	2	270	19,156	42,594	164	12	13	61,939
2. Not insured or guaranteed by FHA or VA												
(a) Amortized	372	1,020	583	123	45	2,143	9,753	13,583	3,781	712	122	27,951
(b) Not amortized	44	19	9	3	6	81	1,607	173	86	23	10	1,899
C. Loans secured by vacant residential lots	24	17	19	12	—	72	24	77	38	17	—	156
Total loans secured by residential properties	5,237	86,083	72,073	31,230	7,633	202,256	55,249	438,883	307,184	104,970	18,448	924,734
II. Loans for construction of residential properties	709	4,890	1,423	511	102	7,635	244,405	69,871	8,775	2,320	464	325,835
III. Loans to nonbank mortgage lenders*	94	1,222	98	11	1	1,426	22,887	13,667	1,527	94	5	38,180
IV. Total residential real estate financing	6,040	92,195	73,591	31,752	7,736	211,317	322,541	522.421	317,486	107,384	18,917	1,288,749

* Loans the proceeds of which will be used for nonfarm residential building.

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construction loan is made, permanent financing in many instances has already been arranged with other lenders, such as insurance companies and savings banks, whose main interest is in long-term investments. The largest banks outside New York City also have a rather good volume of construction loans (70 million dollars on June 30, 1950). A review of the individual reports shows that 12 banks, 6 in New York City and 6 outside New York City, carried 88 per cent of all construction loans in the entire Second District.

The member banks were asked to report also as of June 30, 1950 the dollar amount of undisbursed commitments on residential construction loans. These commitments, in the case of insured loans, are entered into by the bank and the builder after the Federal Housing Administration approves the builder's application for insurance. The provision for insuring real estate loans under Section 608 of the National Housing Act has expired except for applications filed prior to March 1, 1950, which are still subject to approval. The FHA is processing such applications and when this task is completed, no further Section 608 financing will be undertaken. The banks, therefore, can look forward to a decline in the not too distant future in commitments and in the related construction loans. As of June 30, undisbursed commitments by the New York City banks amounted to 419 million dollars, while the largest banks outside New York City (those with total deposits of 20 million or more) had 106 million, and all other Second District member banks had but 5 million.

In the Second District banks outside New York City, permanent mortgage holdings, rather than real estate construction loans, were of major importance. In fact, 373 of these banks, or approximately one half, showed no construction loans on their books on June 30, 1950. The absence of construction loans on a bank's books, however, does not necessarily mean that the bank does not engage in the financing of real estate construction. In some cases a prospective home owner will borrow against a collateral note and execute a permanent mortgage upon completion of the project. In other cases he may execute a mortgage immediately and the bank will make payments to the builder as construction progresses to certain points. To the extent that this may be done, a part of the banks' mortgage holdings in reality represents construction loans.

Table II shows the percentage distribution of the number and dollar volume of the various types of residential mortgages held by the different-sized member banks in the Second Dis-

Table II

Percentage Distribution, by Type of Loan, of the Number and Dollar Volume of Residential Real Estate Loans by Different-Sized Member Banks in the Second Federal Reserve District on June 30, 1950

Type of loan	Number of loans						Dollar amount					
		Member banks outside New York City Deposit size:						Member banks outside New York City Deposit size:				
	New York City central reserve (25 banks)	Over $20 million (82 banks)	$5 to $20 million (267 banks)	$2 to $5 million (243 banks)	Under $2 million (148 banks)	Total Second District (765 banks)	New York City central reserve (25 banks)	Over $20 million (82 banks)	$5 to $20 million (267 banks)	$2 to $5 million (243 banks)	Under $2 million (148 banks)	Total Second District (765 banks)
I. Real estate loans secured by residential properties	86.7	93.4	97.9	98.4	98.7	95.7	17.1	84.0	96.7	97.7	97.5	71.7
II. Loans for construction of residential properties	11.7	5.3	2.0	1.6	1.3	3.6	75.8	13.4	2.8	2.2	2.5	25.3
III. Loans to nonbank mortgage lenders*	1.6	1.3	0.1	†	†	0.7	7.1	2.6	0.5	0.1	†	3.0
IV. Total residential real estate financing	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
I. Real estate loans secured by residential properties												
A. Secured by 1 to 4-family properties												
1. Insured by FHA	55.4	38.2	15.7	7.9	4.1	24.7	31.2	36.8	15.4	9.4	6.0	25.7
2. First lien insured or guaranteed by VA	8.4	19.6	26.7	23.7	23.0	22.6	5.3	23.5	35.2	33.2	34.8	27.6
3. Junior lien guaranteed by VA	12.2	8.1	1.4	1.6	0.4	4.5	1.5	2.3	0.6	0.7	0.2	1.5
4. Not insured or guaranteed by FHA or VA												
(a) Amortized	13.7	32.2	53.7	63.7	65.4	45.5	6.1	24.3	46.4	54.3	54.2	34.5
(b) Not amortized	0.5	0.5	1.7	2.7	6.4	1.5	0.6	0.3	1.1	1.7	4.0	0.8
Total 1 to 4-family properties	90.2	98.6	99.2	99.6	99.3	98.8	44.7	87.2	98.7	99.3	99.2	90.1
B. Loans secured by 5 or more family properties												
1. Insured or guaranteed by FHA or VA	1.4	0.2	†	†	†	0.1	34.7	9.7	0.1	†	0.1	6.7
2. Not insured or guaranteed by FHA or VA												
(a) Amortized	7.1	1.2	0.8	0.4	0.6	1.1	17.7	3.1	1.2	0.7	0.7	3.0
(b) Not amortized	0.8	†	†	†	0.1	†	2.9	†	†	†	†	0.2
Total 5 or more family properties	9.3	1.4	0.8	0.4	0.7	1.2	55.3	12.8	1.3	0.7	0.8	9.9
C. Loans secured by vacant residential lots	0.5	†	†	†	0	†	†	†	†	†	0	†
Total loans secured by residential properties	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Mortgages insured or guaranteed by FHA or VA	77.4	66.1	43.8	33.2	27.5	51.9	72.7	72.3	51.3	43.3	41.1	61.5
Mortgages not insured or guaranteed by FHA or VA	22.6	33.9	56.2	66.8	72.5	48.1	27.3	27.7	48.7	56.7	58.9	38.5

* Loans the proceeds of which will be used for nonfarm residential financing.
† Less than 0.05 per cent.

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trict. In the case of real estate loans secured by residential properties, 61.5 per cent of the entire dollar volume is composed of mortgages insured or guaranteed by the Federal Housing Administration or the Veterans' Administration. Adding the construction loans, which are virtually all FHA-insured, 69.3 per cent of all member bank residential real estate financing is covered by Government insurance or guarantee. From the standpoint of the lender, this insurance or guarantee of course minimizes the possibility of future losses on this type of risk asset. It is also noteworthy that the so-called conventional mortgages (those not guaranteed or insured by a Government agency) which the banks hold, predominantly contain amortization provisions. Neither of these safety factors prevailed before the early thirties, when heavy losses were sustained on mortgage investments. Mortgages not guaranteed or insured accounted for 27.3 per cent of the total dollar volume of mortgage holdings in the large City banks, and for 58.9 per cent of the holdings of the smallest banks.

The largest banks in the District, those with the greatest capitalization and resources, held the bulk of the larger residential mortgages, covering properties of 5 or more families. This was true for both guaranteed and insured mortgages and for conventional mortgages. The proportion of the mortgage portfolio invested in 1 to 4-family FHA mortgages also was greatest in the largest banks. The smaller banks, on the other hand, carried relatively more 1 to 4-family conventional amortized mortgages and more first liens guaranteed or insured by the Veterans' Administration. Apparently, the smaller the bank, the less it tends to deal with builders who initiate FHA mortgages and the more it deals with individual home owners handling their own financing. Each of the three groups of banks with deposits under 20 million dollars held about one third of their mortgage portfolio in VA-guaranteed or insured liens.

Conventional mortgages without provision for amortizing the principal represented only 1 per cent of the aggregate member bank mortgage portfolio as of June 30. The smaller banks generally held a large proportion of the unamortized conventional mortgages on 1 to 4-family properties, while on the larger properties such lending was confined to the large central reserve New York City banks almost exclusively. Mortgage loans secured by vacant residential lots, which normally are considered as carrying the greatest degree of risk, numbered only 72 in the entire Second District, and accounted for a negligible percentage of the dollar volume of all financing.

CHANGES IN CONSUMER CREDIT CONTROL

In the light of persistent upward pressure on prices and the continued growth of bank and consumer credit since the reissuance of Regulation W on September 18, 1950, the Board of Governors of the Federal Reserve System announced on October 13 the adoption of Amendment No. 1 to Regulation W. This amendment became effective on October 16.

Major household appliances, such as radios and television sets, washing machines, and air conditioning units, now require a minimum down payment of 25 per cent instead of 15 per cent, as originally provided by the new Regulation W. Purchases of household furniture and soft surface flooring formerly requiring a down payment of 10 per cent now require 15 per cent down.

The maximum maturity for both these categories and for unclassified instalment loans has been lowered from 18 months to 15 months. Maximum maturity on instalment purchases of passenger cars has also been reduced to 15 months, from the original 21-month maturity requirement. The down payment requirements, which had been applicable only to articles costing $100 or more, now apply to articles selling for $50 or more. However, both the down payment and the maturity requirements still do not apply to articles, other than automobiles, when the credit extended exceeds $2,500.

No change was made with respect to the terms of home improvement credits; for these, the maximum maturity remains at 30 months and the minimum down payment at 10 per cent.

CANADIAN FOREIGN EXCHANGE DEVELOPMENTS

On September 30 the Canadian Government abolished the par value of the Canadian dollar, which since September 19, 1949 had been 90.909 U. S. cents.[1] No new fixed par value was established, the government having decided that the exchange rate should be allowed to move in accordance with supply and demand. Subsequently, the offered price in the New York market for the Canadian dollar rose to a peak of 95.625 U. S. cents on October 3. It stood at 95.31 on October 30. Thus it has moved to a position about midway between parity with the United States dollar, where the official rate in Canada had stood during the period from July 1946 to September 1949,[2] and the official rate that was adopted at the time of the devaluation of sterling in the latter month.

In order to maintain orderly sterling-United States dollar cross rates, the Canadian Foreign Exchange Control Board has announced that it is prepared to buy sterling from and sell it to the Canadian banks against United States funds at the official rates, i.e., US$2.79⅞ and US$2.80⅛. It is understood that such transactions are to be with the head offices only, and that dealings in sterling against United States dollars with correspondents outside of Canada are not permitted.

The decision to let the Canadian dollar fluctuate was accompanied by a government announcement that import restrictions, many of which have been lifted during 1950,

[1] In the New York exchange market, the "unofficial" offered quotation for the Canadian dollar since September 19, 1949 had ranged between 87.50 U. S. cents and parity.

[2] During this period the New York offered quotation ranged between 87.625 U. S. cents and 99.188 U. S. cents.

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would be further relaxed as of the beginning of next year. Subsequently the government increased the allowance of foreign exchange to Canadians for travel abroad. There were, however, no major changes in the exchange control structure, which will be maintained, according to Minister of Finance Douglas Abbott, as a defense against possible adverse conditions in the future. In particular, banks and other authorized agents are to continue to deal in foreign exchange as official agents of the Foreign Exchange Control Board, and all receipts and expenditures of foreign exchange will thus remain subject to the board's regulations. Moreover, Canadian residents still require permits in order to export capital from Canada, and such permits are not normally granted except for necessary business operations and for remittances in limited amounts by immigrants. Similarly, withdrawals of capital from Canada by nonresidents still require licenses and these are normally not granted except in the case of the liquidation of fixed assets in Canada or of other investments made since 1939 and recorded with the Foreign Exchange Control Board. Nonresidents are still able, however, to freely transfer Canadian currency, securities, and other assets among themselves. A nonresident holding Canadian dollars, for example, may dispose of them to his bank in the United States as heretofore.

Gold held by the Canadian authorities continues to be valued at the price of US$35 per ounce, converted into the Canadian dollar equivalent weekly at the average of the noon rates for Monday through Friday. This average rate determines the price in Canadian dollars paid for gold by the Royal Mint. Thus, with the United States dollar at its October 30 premium of 4.92 per cent relative to the Canadian dollar, Canadian sellers would receive Can.$36.72 (i.e., Can.$35 plus a premium of 4.92 per cent) per ounce of gold delivered to the mint, compared with Can.$38.50 prior to September 30. With a view to offsetting, at least in part, the depressing effect of the reduced Canadian dollar mint price on Canadian gold production, the government increased its assistance to the gold mining industry as from October 1.

The changes in Canadian foreign exchange policy were made at the end of a period, approximately a year, during which the country's foreign trade had undergone significant changes. Before 1939 and during the early postwar years Canadian merchandise trade had been characterized by heavy annual deficits with the United States, accompanied by offsetting surpluses with nondollar countries, principally the United Kingdom. Before the war this trade pattern had been sustained by the convertibility into United States dollars of the sterling and other nondollar exchange acquired by Canada in payment for its exports. The convertibility of sterling in turn had been dependent upon the similarly triangular pattern of the British balance of payments, as a result of which the United Kingdom earned sufficient gold and dollars in the overseas sterling area and other third markets to cover

Table I
Canadian Official Holdings of Gold and United States Dollars

End of	Millions of U. S. dollars*
December 1946	1,245
December 1947	502
December 1948	998
March 1949	1,067
June 1949	977
September 1949	985
December 1949	1,117
March 1950	1,192
June 1950	1,255
September 1950	1,789p

* Excludes proceeds of 100 million dollar loan floated by the Government of Canada in the United States in August 1949.
p Preliminary.
Source: Dominion Bureau of Statistics, *Canadian Statistical Review*, September 1950, p. 97.

the British deficits with the United States and Canada. There had also appeared more or less consistently in the prewar period a third triangular pattern under which certain Continental European countries that had deficits with Canada settled such deficits by means of their sterling surpluses.

During the four years immediately following the end of the war the United Kingdom did not earn sufficient United States dollars to close even its trade deficit with the United States, much less develop surplus dollar earnings with which to finance its import balances with Canada. This dislocation of the British prewar trade pattern inevitably disturbed the Canadian balance of payments. In 1947 the Dominion's trade deficit with the United States amounted to more than 900 million Canadian dollars, and its gold and dollar reserves declined during that year from 1,245 million United States dollars to 502 million (see Table I). Somewhat smaller deficits with the United States developed in 1948 and 1949, but Canada succeeded in closing these primarily with "ECA dollars", earned from those Canadian exports to the United Kingdom and other European countries which were financed under the offshore-purchase authorizations of the Economic Cooperation Administration.

During 1950, Canada's international economic problem has been very much eased by a movement toward balance in which both the trade surplus with nondollar countries and the trade deficit with the United States were considerably reduced. Whereas in 1948 and 1949 Canada's trade surplus with the sterling area exceeded 400 million Canadian dollars annually, this surplus dropped during the first half of 1950 to an annual rate of only 80 million (see Table II). Incomplete figures for the third quarter suggest that the surplus may even be replaced by a small deficit. The closer balance in nondollar trade has been achieved through the combination of declining Canadian exports and rising Canadian imports.

Since the devaluations of September 1949 there has also been a spectacular change in Canada's trading position relative to the United States. Whereas during the 1949 business recession in the United States, both United States prices for Canada's major exports and the value of Canadian exports to the United States showed downward trends, these movements have been

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Table II
Canadian Foreign Trade by Major Areas
(In millions of Canadian dollars: annual rates; excluding gold)

Year or quarter	United States	Sterling area*	Union of South Africa	Continental Western Europe†	All other‡	Total‡
EXPORTS#						
1946	901	825	68	304	280	2,379
1947	1,057	1,047	67	310	314	2,796
1948	1,516	929	83	307	291	3,125
1949	1,529	933	76	254	231	3,022
1949-3rd quarter	1,363	971	80	266	222	2,903
1949-4th quarter	1,924	907	57	230	247	3,367
1950-1st quarter	1,694	580	38	136	191	2,640
1950-2nd quarter	1,987	708	58	174	255	3,181
1950-3rd quarter§	2,046	587	38	226	216	3,112
IMPORTS						
1946	1,405	262	8	40	150	1,864
1947	1,975	339	4	64	188	2,570
1948	1,806	490	4	77	260	2,636
1949	1,952	490	4	83	232	2,760
1949-3rd quarter	1,848	493	3	76	235	2,654
1949-4th quarter	1,925	455	3	88	276	2,748
1950-1st quarter	1,834	477	5	70	211	2,597
1950-2nd quarter	2,184	650	4	101	274	3,214
1950-3rd quarter§	2,075	662	4	124	305	3,170
BALANCE						
1946	− 504	+ 563	+ 60	+ 264	+ 130	+ 515
1947	− 918	+ 708	+ 63	+ 246	+ 126	+ 226
1948	− 290	+ 439	+ 79	+ 230	+ 31	+ 489
1949	− 423	+ 443	+ 72	+ 171	− 1	+ 262
1949-3rd quarter	− 485	+ 478	+ 77	+ 190	− 13	+ 249
1949-4th quarter	− 1	+ 452	+ 54	+ 142	− 29	+ 619
1950-1st quarter	− 140	+ 103	+ 33	+ 66	− 20	+ 43
1950-2nd quarter	− 197	+ 58	+ 54	+ 73	− 19	− 33
1950-3rd quarter§	− 29	− 75	+ 34	+ 102	− 89	− 58

* United Kingdom, Eire, India, Pakistan, Burma, Australia, New Zealand, Iceland, Ceylon, Iraq, and British dependencies.
† Including colonies.
‡ Trade with Newfoundland included through March 1949, prior to union with Canada. In 1948 Canada's exports to Newfoundland were valued at 55.1 million Canadian dollars while imports from Newfoundland were 11.1 million.
# Including re-exports.
§ Estimates on the basis of incomplete data.
Note: Because of rounding figures do not necessarily add up to the totals shown.
Source: Bank of Canada, *Statistical Summary*, September 1950, p. 153; Government of Canada, *Trade of Canada: Exports*, August 1950, and *Trade of Canada: Imports*, July 1950.

reversed in 1950. With the revival of business activity here, United States wholesale prices for commodities important in Canada's export trade rose markedly. The index of paper and pulp prices increased from 156 to 164 between January and August 1950 (1926=100), nonferrous metal prices from 129 to 156, timber prices from 288 to 357, and food prices from 155 to 175 (see Table III). Simultaneously, Canadian exports to the United States expanded from an annual rate of 1,363 million Canadian dollars in the third quarter of 1949 to almost 2,000 million in the second quarter of this year, and probably more in the third quarter (see Table II). On the other hand Canadian imports from the United States expanded only moderately in spite of the progressive relaxation of the Dominion's controls over such purchases. From an annual rate of 1,848 million Candian dollars in the third quarter of last year, such imports rose to 2,184 million in the second quarter of 1950; the annual rate for July and August combined was somewhat under 2,100 million.

Thus Canada's trade deficit with the United States was more than halved between the third quarter of 1949 and the second quarter of this year, falling from an annual rate of 485 million Canadian dollars to only 197 million. It appears likely that in the third quarter of this year the deficit was almost completely eliminated.

Concurrently with this improvement, Canada's gold and dollar reserves have risen to 1,789 million United States dollars on September 30, 1950, from 985 million a year earlier. Although the rise in reserves has been in part a reflection of the country's improved trade position vis-a-vis the United States, and of some net inflow of long-term investment capital, it reflects also, to a considerable extent, a flow of speculative funds from residents of the United States who, in the light of Canada's increasing economic strength, anticipated an appreciation of the Canadian currency. After the outbreak of the Korean war and the adoption of an expanded United States defense program, this flow of speculative capital to Canada seems to have become particularly heavy. During the third quarter of 1950 alone Canadian gold and dollar reserves rose by 534 million United States dollars, and more than half of this increase took place in September.

This movement of speculative capital has not been looked upon with favor by the Canadian authorities. On September 30, 1950 Minister of Finance Douglas Abbott stated that:

> An influx of funds on this tremendous scale would, if it continued, be likely to exercise an inflationary influence in Canada at a time when government policy in all fields is directed to combating inflationary developments. Moreover, the accumulation of foreign exchange under such conditions would mean that Canada was in effect incurring a substantial increase in its gross foreign debt and annual service charges without any corresponding increase in its productive resources or ability to export.

In addition to the inflow of speculative funds, an upward movement in the prices of Canada's principal imports during 1950 also has exerted inflationary pressure on the country's economy. In the United States, where Canada purchases more than half of its imports, the general wholesale price index increased during the first eight months of this year from 152 to 166 (1926=100), and there were similar upward movements in the prices of most of Canada's major imports from this country (see Table IV). There were also considerable advances during the first eight months of the year in

Table III
United States Wholesale Prices for Commodity Groups Important in Canada's Export Trade
(1926=100)

Selected months, 1949 and 1950	Paper and pulp	Nonferrous metals	Lumber	Foods
January 1949	168	173	300	166
March 1949	167	168	295	163
June 1949	160	129	281	162
October 1949	157	132	282	160
January 1950	156	129	288	155
March 1950	156	127	296	156
June 1950	155	148	323	162
July 1950	160	151	338	171
August 1950	164	156	357	175

Source: United States Department of Labor, *Average Wholesale Prices and Index Numbers of Individual Commodities*, various issues in 1949 and 1950.

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Table IV
United States Wholesale Prices for Commodity Groups Important in Canada's Import Trade
(1926=100)

Selected months, 1949 and 1950	General index	Textile products	Bituminous coal	Petroleum and products	Iron and steel
January 1949...	161	146	197	121	169
March 1949...	158	144	195	116	168
June 1949...	155	139	189	110	165
October 1949...	152	138	191	110	163
January 1950...	152	139	196	109	167
March 1950...	153	137	199	109	169
June 1950...	157	137	192	114	169
July 1950...	163	143	192	116	170
August 1950...	166	149	193	117	170

Source: United States Department of Labor, *Average Wholesale Prices and Index Numbers of Individual Commodities*, various issues, and Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin* (October 1949 and September 1950).

the prices of Canada's principal imports from countries other than the United States, notably coffee and rubber.

While the new foreign exchange policy was probably expected to put downward pressure on the Canadian dollar prices of imports, its primary aim according to the Minister of Finance was to stop the influx of speculative capital from the United States. In searching for a means of achieving the latter objective, the Canadian authorities rejected a restoration of the Canadian dollar to a fixed parity with the United States dollar. The attitude of the Canadian Government was explained on September 30 by Mr. Abbott, who stated that while such a measure "would probably bring to a stop the inward movement of speculative capital", a revaluation of the Canadian currency to parity with the United States dollar:

> would not necessarily be justified by fundamental conditions and might be found to require reversal or further adjustment within the not too distant future. To move the Canadian exchange rate to any other fixed point than parity with the United States dollar would be open to the same objections.

In adopting its new foreign exchange policy, the Canadian Government consulted the International Monetary Fund. The government intends, Mr. Abbott has stated, "to remain in consultation with the Fund and hopes ultimately to conform to the provisions of the [Fund's] articles of agreement which stipulate that member countries should not allow their exchange rates to fluctuate more than one per cent on either side of the par value from time to time established with the Fund". In a statement dealing with the new exchange rate policy the Fund indicated that it recognized the exigencies of the situation that had led to the Canadian action and took special note of the intention of the Canadian Government "to re-establish an effective par value as soon as circumstances warrant".

DEPARTMENT STORE TRADE

The year-to-year gain in the dollar sales volume of Second District department stores during October was the smallest since June. Preliminary estimates indicate that sales during October were only about 5 per cent above those of October 1949.

A recent survey conducted by this bank among department stores in the New York City area revealed a decided slackening in the sales volume of many of the durable housefurnishings lines. During the three weeks ended October 21, sales of major household appliances, for example, were 8 per cent below those of the comparable period a year ago. In the radio-television departments, dollar sales for the week ended October 21 were only 13 per cent above those of the same week in 1949. (For the weeks ended October 7 and 14, the year-to-year increases were 66 and 39 per cent, respectively.) The restrictions on consumer credit, which were stiffened during the latter part of this three-week period, were largely but by no means solely responsible for the lag in sales of hard goods. The color television controversy, the reaction from the large volume of anticipatory buying in the summer and early fall, and other developments also influenced the sales volume of consumers' durables.

Recent Inventory Policy

As the final quarter of 1950 got under way, retailers in this District, as elsewhere in the United States, were uncertain about the effect on retail trade of the enlarged defense program and the accompanying economic measures. Will the tightened restrictions on instalment buying, which affect almost exclusively durable goods sales, stimulate consumer interest in the soft goods lines, particularly men's and women's apparel? What will be the net effect of the new regulations governing residential mortgage credit on the retail sales of housefurnishings and appliances and on sales in general? How will the rearmament program affect supply conditions for consumers' goods? These are some of the questions which department store executives were trying to answer. The significance of these problems varies in the different sections of the country according to the nature of the local economy. For example, in this District, particularly in New York City, personal income is less sensitive to a sudden expansion or contraction in the durable goods industries than it is in many other sections of the country.

Since the start of the war in Korea, the accumulation of inventories has been a major concern of the retailers. In this District, however, it was not until the end of September that the year-to-year increase in department store stocks outdistanced the rise in sales. With the midsummer sales volume at a record seasonal peak, the stores in July began to increase sharply the volume of their orders to manufacturers, in order not only to make up for the rapid depletion of their stocks but also to provide a safety margin against possible future shortages. As the chart shows, outstanding orders at the end of July were more than double those recorded as of June

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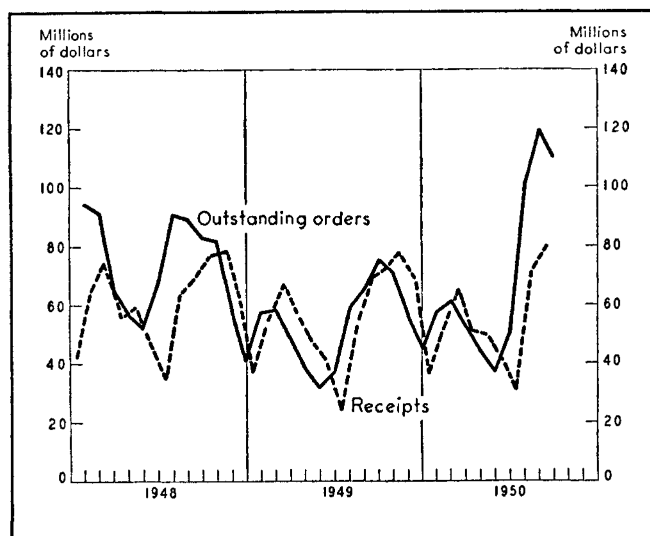
Estimated Receipts of Merchandise and Outstanding Orders of Second District Department Stores, 1948-September 1950*
(Without adjustment for seasonal variation)



* For a group of stores whose 1949 sales equaled more than half of the estimated Second District total. Outstanding orders are end-of-month data, receipts are monthly totals.

30, 1950, and new orders were almost 60 per cent higher. During August the flow of incoming merchandise to the stores increased markedly, and the ability of manufacturers and suppliers to fill promptly orders for most merchandise lines dispelled the fears of immediate shortages in consumer goods.

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

Locality	Net sales		Stocks on hand Sept. 30, 1950
	Sept. 1950	Jan. through Sept. 1950	
Department stores, Second District....	+ 8	+ 2	+14
New York City..................	+ 7	+ 1	+16
Northern New Jersey.............	+10	+ 5	+10
Newark.......................	+ 8	+ 3	+ 9
Westchester County...............	+13	+ 5	− 2
Fairfield County..................	+13	+ 7	+11
Bridgeport.....................	+13	+ 8	+13
Lower Hudson River Valley........	+ 6	+ 2	+ 6
Poughkeepsie..................	+ 6	+ 1	+ 8
Upper Hudson River Valley........	+ 5	+ 1	+ 3
Albany........................	+ 8	0	− 2
Schenectady..................	+ 2	− 1	+12
Central New York State...........	+14	+ 6	+11
Mohawk River Valley...........	+17	+ 6	+12
Utica.......................	+16	+ 6	+21
Syracuse......................	+12	+ 5	+11
Northern New York State..........	+ 6	+ 3	− 1
Southern New York State..........	+13	+ 4	+ 9
Binghamton....................	+10	+ 2	+10
Elmira........................	+21	+10	+ 5
Western New York State...........	+ 8	+ 2	+17
Buffalo.......................	+ 5	+ 1	+21
Niagara Falls..................	+14	+ 7	+11
Rochester.....................	+10	+ 4	+12
Apparel stores (chiefly New York City).	+ 9	0	+12

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

Item	1949	1950		
	Sept.	July	August	Sept.
Sales (average daily), unadjusted.........	247r	192	202	267
Sales (average daily), seasonally adjusted..	242r	274	277	262
Stocks, unadjusted......................	227r	194	226	256
Stocks, seasonally adjusted..............	215r	218	226	243

r Revised.

By the end of August, the value of orders outstanding at Second District department stores reached the highest level since November 1946, and the dollar volume of receipts during September surpassed that of the previous month. However, the amount of new orders fell off substantially during September from the August level, so that on September 30 the value of outstanding orders was slightly below the August peak. By this time, the retail value of stocks held by Second District department stores was the greatest since November 1948, when the dollar amount of inventories had reached its all-time high.

Indexes of Business

Index	1949	1950		
	Sept.	July	August	Sept.
Industrial production*, 1935-39 = 100..... (*Board of Governors, Federal Reserve System*)	174	196	209	211p
Electric power output*, 1935-39 = 100.... (*Federal Reserve Bank of New York*)	255	288	297	298
Ton-miles of railway freight*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	151	188	193p	
Sales of all retail stores*, 1935-39 = 100..... (*Department of Commerce*)	337r	394r	394	376p
Factory employment				
United States, 1939 = 100............. (*Bureau of Labor Statistics*)	144	148	156	158p
New York State, 1935-39 = 100......... (*NYS Div. of Placement and Unemp. Ins.*)	118	113	121	125p
Factory payrolls				
United States, 1939 = 100............. (*Bureau of Labor Statistics*)	335	367	394	400e
New York State, 1935-39 = 100......... (*NYS Div. of Placement and Unemp. Ins.*)	283	277	306	308p
Personal income*, 1935-39 = 100.......... (*Department of Commerce*)	297	322	326p	
Composite index of wages and salaries*‡, 1939 = 100.......................... (*Federal Reserve Bank of New York*)	202	208	210p	
Consumers' prices, 1935-39 = 100......... (*Bureau of Labor Statistics*)	170	173	173	174
Velocity of demand deposits*, 1935-39 = 100 (*Federal Reserve Bank of New York*)				
New York City.......................	106	113	145r	130
Outside New York City...............	89	97	102	102

* 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.

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NATIONAL SUMMARY OF BUSINESS CONDITIONS

(Summarized by the Board of Governors of the Federal Reserve System, October 27, 1950)

Industrial activity, employment, and payrolls increased somewhat further in September and early October. Business and consumer demands for goods were less active after mid-September and wholesale commodity prices showed little change. Retail prices continued upward, reflecting in part earlier advances in wholesale markets. Credit to business, consumers, and real estate owners expanded considerably further. Consumer credit regulations, which became effective on September 18, were tightened on October 16 and housing credit restrictions were put into effect October 12.

Industrial Production

Industrial production showed a small further increase in September and early October, following the sharp advance in August. Reflecting mainly continued gains in output of iron and steel and their products, machinery, and crude petroleum, the Board's seasonally adjusted index rose from 209 in August to 211 in September. In October, a further small increase is likely, as a result chiefly of expanded output of steel and of producers' durable goods and military equipment.

Steel production increased in September to a level slightly above the June rate, and in October has advanced about 3 per cent further to a new record. The gain in activity in machinery industries in September was much smaller than in August, mainly because labor disputes curtailed operations in some important plants. Automobile production continued close to the high level of recent months. In view of the growing volume of defense production and the limited supply of metals and certain other industrial materials, the National Production Authority has established a priority system for defense orders.

Output of textile, paper, rubber, and petroleum products in September was maintained at the exceptionally high levels reached in August. Meat production rose much more than seasonally. In mid-October, the National Production Authority announced more stringent measures to curtail consumption of rubber in civilian products.

Output of crude petroleum advanced further to a new record rate in mid-September but subsequently leveled off. Coal output showed little change and production of iron ore was maintained in record volume over this period.

Construction

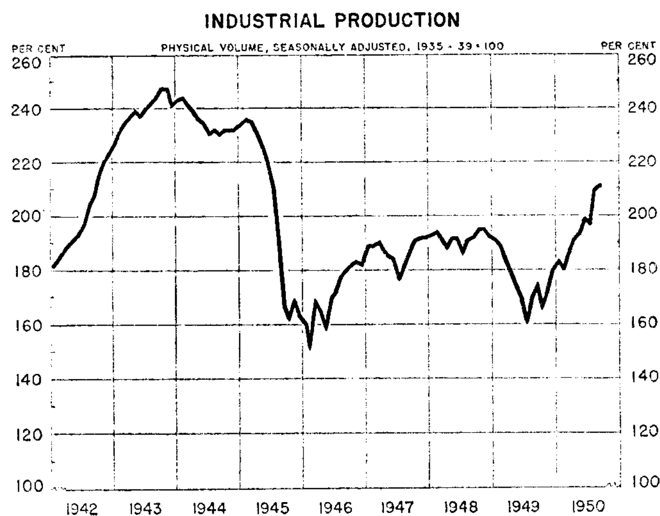
Contracts awarded in September for most types of private and public construction declined more than seasonally from the record summer level. The number of housing units started in September was estimated to be 115,000. This was 28,000 fewer units than the average number started during the summer months but 12,000 more than in September 1949.

Employment

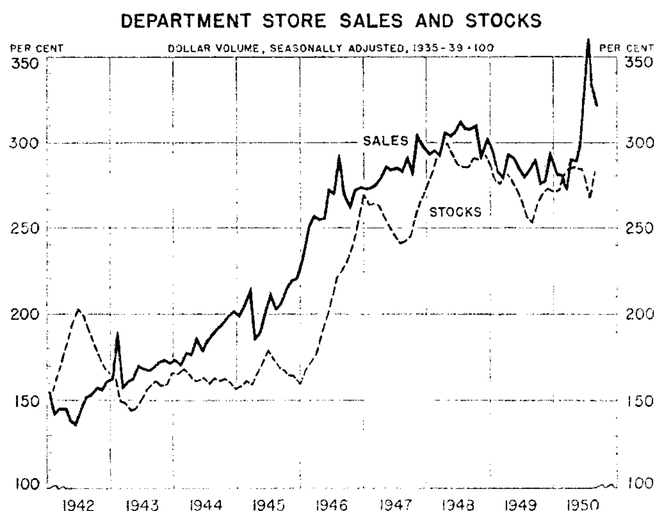
The total number employed in nonagricultural industries was at an all-time high of about 45 million in September, 2 million more than in September 1949. Unemployment declined moderately further to 2.3 million and was at the lowest level since late 1948.

Distribution

Consumer buying showed less than the usual seasonal increase in September and early October from the peak rates reached during the summer. Value of purchases, however, remained substantially above year-ago levels, reflecting in part higher prices. Purchases of durable goods continued above the high levels reached during the first half of this year. Distributor stocks of most goods have increased further in this period following a reduction in July. At department stores value of stocks by the end of September was about one-fifth above the relatively low level reached a year ago.



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



Federal Reserve indexes. Monthly figures; latest figure for sales is September; latest for stocks is August.

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Commodity Prices

The average level of wholesale prices changed little from mid-September to the third week of October, as livestock and meat prices showed seasonal declines and increases in prices of nonfood commodities slowed down. Prices of industrial materials leveled off as buying became less urgent, and increases in finished goods were less numerous.

The consumers price index rose 0.5 per cent from mid-August to mid-September, reflecting mainly marked increases in retail prices of apparel and housefurnishings. Since that time additional advances in these and other goods have been announced.

Bank Credit

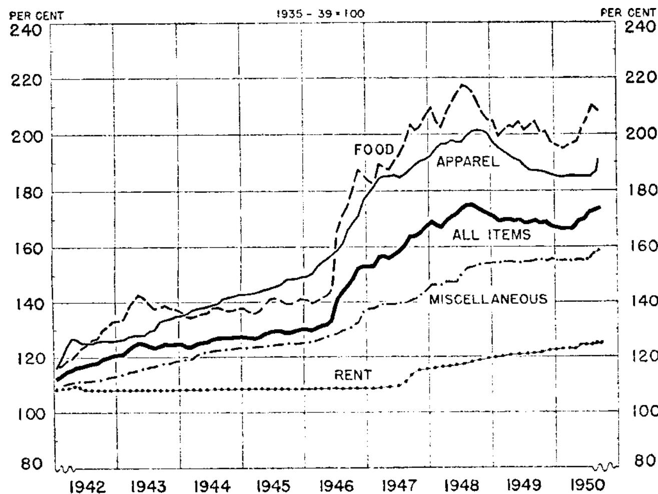
Total loans and corporate and municipal security investments of commercial banks showed further sharp increases during September and the first half of October. The expansion at banks in leading cities totaled 1.8 billion dollars and brought the total rise at these banks since June to almost 4 billion. Business loans increased much more than seasonally while loans to real estate owners and consumers continued to rise substantially.

Treasury deposits at Federal Reserve Banks, which were large in late September owing to tax collections, were drawn down in the first three weeks of October, thus supplying a substantial volume of reserve funds. Outflows of currency into circulation and of gold and cash redemption of part of the maturing Treasury bills held by the Reserve Banks absorbed some of these funds. Commercial banks, however, continued to sell Government securities, in part to the Federal Reserve System, and built up their excess reserve balances.

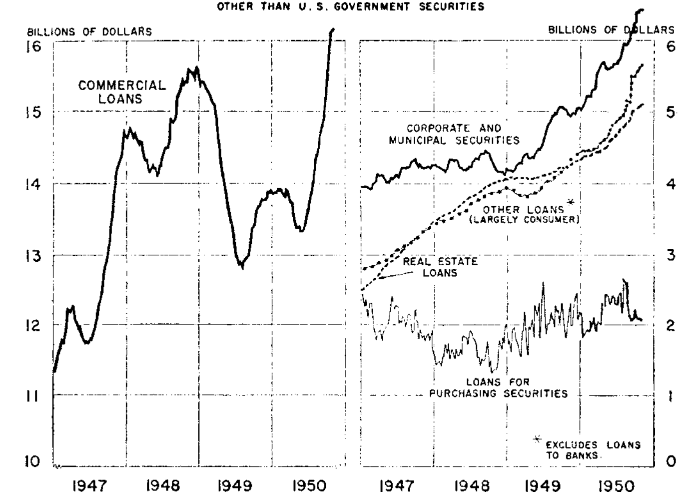
An increase in interest rates to bank customers, initiated in New York City in late September, became more widespread in early October.

Security Markets

Common stock prices, after rising somewhat further in the first two weeks of October to the highest levels since September 1930, showed little change during the following 10 days. Yields on most bank-eligible Treasury securities increased further in the first three weeks of October, while yields on Treasury bills declined somewhat. There was little change in yields on long-term Treasury and high-grade corporate bonds.



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



Commercial loans include commercial, industrial, and agricultural loans. Wednesday figures; latest shown are for October 18.

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