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MONEY MARKET IN MARCH

Both the money market and the Government security market were dominated throughout the past month by events growing out of the joint announcement by the Secretary of the Treasury and the Chairman of the Board of Governors, and of the Federal Open Market Committee, of the Federal Reserve System, released for publication on March 4:

> The Treasury and the Federal Reserve System have reached full accord with respect to debt-management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetization of the public debt.

This announcement was accompanied by another, stating that the Treasury would offer in late March and early April a 2¾ per cent long-term nonmarketable bond in exchange for its bank-restricted 2½ per cent issues of June and December 1967-72. The markets reflected initial uncertainty over the meaning of the fundamental agreement that had been reached, as well as varying anticipations concerning the detailed terms of the exchange offering that were still to be revealed. But it soon became clear through the action of the Government security market that the Federal Reserve System had withdrawn its former supports; and a well-ordered readjustment occurred, with Government security prices moving to generally lower levels in response to underlying supply and demand conditions.

During the first few days following the announcements, holders of the restricted bonds affected by the conversion offering were given an opportunity to sell these securities at previously existing prices, and substantial amounts were purchased by the Federal Reserve System and Treasury investment accounts. The funds so released were used in part to purchase short-term Government securities, and contributed both to a slight firming in prices of those securities and also to easy conditions in the money market through the middle of the month. An unusually large increase in Federal Reserve "float" and new procedures for the collection of corporate tax payments helped to continue the market ease until the final statement week of the month, when the eventual tightening following the March 15 tax date and a reduction of "float" sent the rate on immediately available Federal funds close to the discount rate and caused an increase in member bank borrowing from the Reserve Banks.

With one exception, prices of all outstanding restricted bonds had fallen below par by the 13th of the month, more or less leveling off thereafter; by the month end, all ten of the restricted bonds were relatively steady at prices ranging between 99 and 100. The price changes represented a general rise of about ⅛ of 1 per cent in yields. Changes in the prices and yields of bonds eligible for bank ownership (including the partially tax-exempt issues) were considerably smaller, except for the one long-term taxable bond of September 1967-72, and none actually moved below par until late in the month. Prices of four selected eligible and restricted bonds have been plotted on the accompanying chart. Yields on the longer-term Treasury notes rose gradually throughout the month, with an over-all increase of roughly ¼ of 1 per cent in yield, as prices declined to between 98 and 99. Reflecting a sudden tightening of the money market and the flexibility appropriate to freer market conditions, yields on Treasury bills and shorter-term securities rose abruptly by about ⅛ of 1 per cent toward the end of the month. A summary of changes in yields for a selection of representative securities is presented in the table on page 46. Throughout all of March, while the most comprehensive price and yield adjustments of the postwar period were taking place, reasonably active two-way trading continued in the market for all principal classes of Government securities.

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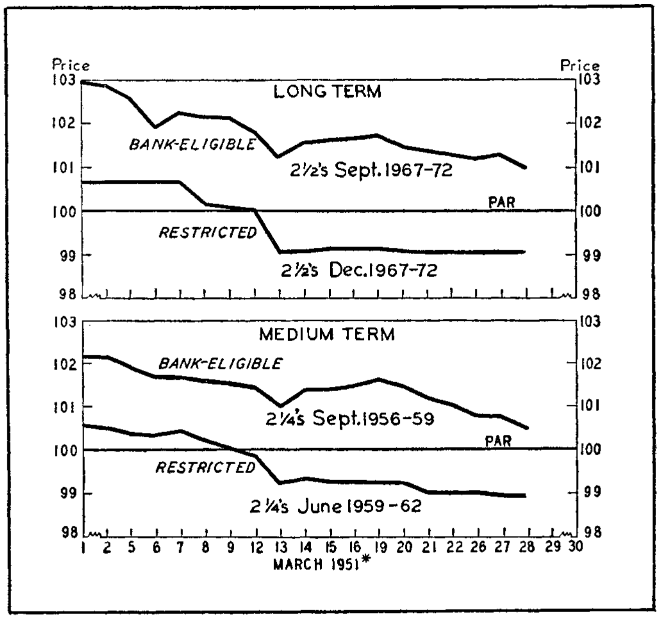
Closing Bid Prices of Selected Treasury Bonds, March 1951



* Saturdays, Sundays, and Good Friday (when no trading occurred) are omitted.

Government Security Market

The Treasury's conversion offer introduced a new type of debt instrument—a long-term bond that is to be nonmarketable and nonredeemable, although holders may at their own option exchange the bond at any time for a marketable note. At a 2¾ per cent yield for a term of 24 to 29 years, the bond would presumably appeal to *bona fide* long-term investors. In the event of unforeseen requirements, such investors may exchange the new bond for a five-year 1½ per cent note, which can in turn be sold in the market at whatever the prevailing prices for such securities may be. Instead of the rigid schedules of future redemption values which have customarily been incorporated in past offerings of nonmarketable bonds, this bond can, in effect, be converted into a liquid asset only on terms which will vary with changes in the market prices of five-year Government securities; and instead of cash redemption by the Treasury on demand, holders will have to satisfy their desire for liquidity through the market. Thus the uncertain incidence upon the Treasury of cash redemptions on the basis of predetermined price schedules, a characteristic of previous types of nonmarketable bonds, will be eliminated. The investor, on the other hand, is afforded an opportunity to obtain a long-term Treasury obligation bearing a yield to maturity considerably above that currently earned on the 2½ per cent restricted bonds of June and December 1967-72 to which the exchange privilege has been extended.

Only the broad outlines of this innovation in debt management techniques were presented in the original Treasury announcement of March 4. While the Government security market was beginning to digest the implications of the historic policy announcement cited above in the opening paragraph, purchases of the "exchange issues" of 1967-72 by the Federal Reserve and Treasury accounts, and by others wishing to obtain the bonds for conversion into the new issue, provided a steadying influence in the market. On March 8, after immediate market reactions had been assimilated, and general appraisals of the nature of the conversion offering had been formed, the Treasury announced the term of the nonmarketable bond, and the term and coupon to be attached to the marketable note. Simultaneously, support purchases of the "exchange issues" at previously existing prices ceased, and the market for these issues quickly adjusted to prices in the neighborhood of par, at which some trading then took place. It soon became apparent, however, that the prevailing influences upon supply and demand evidenced in other sectors of the long-term market were moving toward an equilibrium at somewhat lower prices. Consequently, on March 13, the prices of the "exchange issues" worked their way to a new level at 99-2/32, and an analogous realignment occurred among all of the other restricted bonds, as well as the longer-term bank-eligible issues. On March 18, final details of the exchange offering were announced.

In the statement week ended March 21, Federal Reserve bond purchases were small and were more than offset by sales of Treasury bills and notes. System Account purchases were increased in the final week of the month to serve the dual purpose of relieving the intense pressure on member bank reserves, which developed at that time, and of maintaining orderly conditions in the Government security market. The purchases included a variety of issues, and aggregated roughly 260 million dollars. The Federal Reserve System, however, determined its purchases or sales primarily in accordance with general developments in the money market and credit situation and with a view to maintenance of those orderly market conditions that are essential for successful debt management and effective credit policy.

Yields of Selected U. S. Government Securities during March 1951*

Issue	Mar. 29	Mar. 13	Mar. 8	Mar. 5	Mar. 2
Bonds					
2½'s December 1967-72#	2.56†	2.56†	2.49	2.45	2.45
2½'s September 1967-72	2.44	2.41	2.34	2.31	2.29
2¼'s June 1959-62#	2.36‡	2.33‡	2.22	2.20	2.18
2¼'s September 1956-59	2.20	2.06	1.95	1.89	1.85
2½'s March 1952-54	2.01	1.80	1.72	1.67	1.61
Notes					
1¾'s March 1954	2.01	1.93	1.78	1.74	1.66
1¼'s October 1, 1951	1.64	1.48	1.49	1.54	1.48
Treasury bills					
Nearest 3-month maturity	1.53	1.40	1.39	1.39	1.39

* Percentage yields to nearest call or maturity date. Based on closing bid prices for selected dates.

\# Ownership restricted to nonbank investors.

† Yield to maturity; yield to call date, 2.57 per cent.

‡ Yield to maturity; yield to call date, 2.36 per cent on March 13 and 2.40 per cent on March 29.

VOLUNTARY CREDIT RESTRAINT

On March 9, 1951, the Board of Governors of the Federal Reserve System announced the inauguration of a Program for Voluntary Credit Restraint which had been developed by representatives of financing institutions and approved by the appropriate Government officials. On March 20, 1951, the Voluntary Credit Restraint Committee, appointed by the Board of Governors, released its Bulletin No. 1 under the program. Copies of the program and bulletin are available from this bank without charge. Requests for reprints should be addressed to the Press and Circulars Division, Federal Reserve Bank of New York, New York 45, N. Y.

Toward the close of the month, partly as a reaction to the sharp tightening of the money market that had brought Treasury bill yields to a peak of 1.53 per cent (bid) on the 26th, prices of several of the bank-eligible bonds (all of which had thus far remained above par) sagged to around the par level. This development led some dealers and others to review their pricing practices, which have customarily been based upon the call dates of individual bonds without much concern for the date of ultimate maturity. Apparently it was in part because of a shift of thinking to prices based upon maturity dates that the taxable 2 per cent bonds of December 1951-55 were the first of the bank-eligible bonds to drop below par. This type of adjustment was another evidence of the greater responsiveness to appraisals developed within the market itself that might well be expected as a consequence of greater flexibility and freedom of the market.

Member Bank Reserve Positions

Member bank reserve positions were relatively easy during most of the first three weeks of March, but were under heavy pressure in the latter part of the month. Excess reserves for the country as a whole were at the moderately low level of about 650 million dollars at the end of February and rose above 1 billion dollars around the middle of March; by the end of the month they were running around 450 million dollars. Along with the net reduction in excess reserves, member bank borrowing from the Reserve Banks became increasingly important. Total borrowings by member banks fell from 398 million dollars on February 28 to 132 million on March 14, and then increased to 471 million on March 28.

As noted above, net Federal Reserve purchases of Government securities were a principal source of reserves, except for the third week; the aggregate increase for the month as a whole was 725 million dollars. The reserve funds supplied by these purchases, together with a net increase in member bank borrowing of about 75 million dollars and a moderate return flow of currency from circulation, approximately balanced the drains on bank reserves from other sources. These drains included net Treasury receipts, a net reduction in Federal Reserve float, and a further outflow of gold.

Treasury balances at the Federal Reserve Banks rose nearly 600 million dollars, net, during the month with a concentration in the final statement week. The greater tightening influence on the reserve position of the banks that might have been expected, in view of the substantial increase in tax receipts over last year, was modified in part by the introduction of new collection procedures, effective March 5-31, which permitted the larger checks drawn in payment of corporation taxes to be credited to an account established for the Treasury at the banks on which these checks were drawn. Subsequent Treasury calls on these accounts, as in the case of the customary Tax and Loan Accounts, could be spaced out over some time in order to avoid the extreme stringency which otherwise would have been created by a convergence of large drains upon bank reserves shortly following the March 15 tax date. Two substantial withdrawals from these accounts were made by the Treasury before the end of the month, but large amounts (estimated at about 2¾ billion dollars) still remained in the banks at the end of March.

In addition to the Treasury drain upon bank reserves, a reduction of more than 125 million dollars resulted from an over-all decline in Federal Reserve "float" (credits to member bank reserve accounts for checks not yet actually collected). The "float" had, however, been a substantial source of reserve funds through much of the last half of the month,

BANK RESERVES—SOME MAJOR FACTORS AFFECTING THEM

In recent years, the *Monthly Review* has contained various special articles discussing the reserve requirements and reserve balances of commercial banks and the factors affecting reserve balances. Several of these articles have now been revised, brought up to date, and republished in the form of a booklet, entitled *Bank Reserves—Some Major Factors Affecting Them.* The reprinted articles deal with specific topics which normally are given relatively little attention in general textbooks on money and banking. This booklet will be sent free of charge to anyone who is interested in receiving it. Requests should be addressed to the Domestic Research Division, Federal Reserve Bank of New York, New York 45, N. Y.

reaching a peak volume in excess of 1.5 billion dollars on one date; by the month end, it had fallen back to about 750 million dollars. Continuation of the gold outflow, and increases in dollar balances held at the Reserve Banks by foreign governments and central banks, accounted for a further drain of about 300 million dollars. Thus gross reductions of member bank reserves approximately balanced the gross increase of roughly one billion dollars. The reduction in excess reserves, noted above, was accounted for by the increase in reserve requirements associated with a moderate expansion of deposits. Actually, private demand deposits declined, while Treasury deposits at the member banks increased. The accompanying increase in member bank earning assets, judging from incomplete data for the weekly reporting banks, was apparently concentrated in increased holdings of Treasury bills by some of the banks, although business loans also rose substantially.

The reserve positions of member banks in New York City reflected the general nationwide fluctuations in magnified form. At the beginning of the month, with substantial transfers of funds to other parts of the country occurring, the money market was tight and Federal funds exchanged at rates from 1¼ to 1¾ per cent. After March 5 the market eased considerably, and with the exception of one day remained easy until the 22nd, when the Federal funds rate moved up close to the discount rate, where it remained for the rest of the month. The change in Treasury tax procedures, and the midmonth rise in float, were particularly advantageous to the New York City banks, reducing the outward drain upon city funds as well as reducing the direct drain arising from tax checks drawn on their own deposits.

WESTERN GERMANY'S INTERNATIONAL ECONOMIC POSITION

Late in February the Government of Western Germany temporarily suspended the issuance of licenses for those imports from the European Payments Union area which had been liberalized under the program of the Organization for European Economic Cooperation. A few days later, the government decided in principle not to issue additional licenses nor to "confirm" foreign exchange allocations for nearly all quota (i. e., non-liberalized) imports from European Payments Union participants. These developments drew attention to the basic imbalance of Western Germany's international economic position.

Under the liberalization program of the OEEC, member countries had to lift quantitative restrictions first on one half and subsequently on a further 10 per cent of their imports on private account from other members. Efforts are now being made by the OEEC to increase the total reduction in quantitative restrictions to 75 per cent. The import liberalization policy had greatly benefited Western Germany's exports, and had found staunch support in that country. However, stringent restrictions on the issue of import licenses became unavoidable because of the steady growth in the country's deficit vis-a-vis the EPU[1] and because of the depletion by the end of February of more than three quarters of the special 120 million dollar credit granted to Germany by the EPU last December. Unless soon relaxed, the new import controls may well deal a heavy blow to intra-European trade and cause a severe setback to the multilateral payments system sponsored by the OEEC.

The lack of balance in Western Germany's external accounts was accompanied by a steady improvement in that country's internal economic position during most of 1950. By November, the industrial production index had reached a new peak of 130 (1936=100), against 97 a year earlier. There was a sharp though largely seasonal decline to 117 in January 1951, but the index nevertheless stood 31 per cent higher in that month than in January 1950, and about 10 per cent above its level at the time of the outbreak of the Korean conflict. The number of employed wage and salary earners rose by 4.5 per cent during 1950 despite increasing shortages of coal and coke, and notwithstanding a decline toward the end of the year in the production of iron, steel, and electric power in consequence of these shortages.

This very encouraging over-all expansion of economic activity was in turn accompanied by a substantial increase in the country's foreign trade. Imports into Western Germany, as brought out in Table I, rose from 2.2 billion dollars in 1949

Table I
Western Germany's Foreign Trade
(In millions of dollars; including West Berlin)

Year and quarter	Imports: Total	Imports: "Commercial" only	Imports: GARIOA* and ERP	Total exports	Balance: Total	Balance: "Commercial" only
1949–I	447.3	179.1	268.2	254.8	− 192.5	+ 75.7
II	594.9	361.4	233.5	283.9	− 311.0	− 77.5
III	559.1	342.5	216.6	300.5	− 258.6	− 42.0
IV	635.4	397.9	237.5	283.8	− 351.6	−114.1
Year	2,236.7	1,280.9	955.8	1,123.0	−1,113.7	−157.9
1950–I	593.9	465.3	128.6	356.4	− 237.5	−108.9
II	526.7	422.3	104.4	421.9	− 104.8	− 0.4
III	669.9	550.2	119.7	514.0	− 155.9	− 36.2
IV	913.4	785.7	127.7	688.3	− 225.1	− 97.4
Year	2,703.9	2,223.5	480.4	1,980.6	− 723.3	−242.9

* Government and relief in occupied areas.
Note: + indicates export surplus; − indicates import surplus.
Source: *Monthly Report of the Bank Deutscher Laender*, December 1950, page 38

[1] The European Payments Union was described in an article in the September 1950 issue of this *Review*. Reprints of the article are available upon request from the Press and Circulars Division, Federal Reserve Bank of New York, New York 45, N. Y.

to 2.7 billion in 1950. Exports, increasing even faster than imports, last year almost reached 2 billion dollars, resulting in a sharp contraction in the over-all import surplus. This contraction, however, was more than offset by a reduction in United States Government financing of Western German imports, and the country's "commercial" import surplus (the excess of "commercial" imports over exports) consequently rose from 158 million dollars in 1949 to 243 million in 1950.

Together with the price effects of the September 1949 currency devaluations and the increased availability of supplies in Europe and its dependent areas, this cut in American aid led to a significant and impressive shift of Western Germany's supply sources from the dollar area to countries participating in the European Payments Union. As indicated in Table II, Germany reduced her imports from the Western Hemisphere from 993 million dollars in 1949 to 626 million in 1950, and increased her imports from EPU countries and their monetary areas from 1,014 million dollars to 1,861 million. Since Germany's exports to EPU countries expanded much less than its imports from those countries, there was a very heavy rise in the deficit with the EPU participants, from a mere 65 million dollars in 1949 to 366 million dollars in 1950. Even with considerable EPU aid, an imbalance of such proportions was bound to result in payment difficulties. It is true, however, that Germany at the same time succeeded in sharply stepping up its exports to the United States and other Western Hemisphere countries, as well as to some other parts of the world.

To a considerable extent, the payment difficulties with the EPU were caused by special factors primarily attributable to the outbreak of the Korean conflict last summer. At that time, German importers, who because of softness in some raw material prices during the second quarter of 1950 had been slow in covering their needs, became fearful of falling behind in the incipient scramble for raw materials and foodstuffs, and rushed into the market as prices were rapidly rising. Since the prices of German exports were increasing only slowly, the terms of trade turned sharply against Germany. Most of the raw materials and foodstuffs needed by Germany were readily available in the countries participating in the EPU or their associated monetary areas, and since a large proportion of these commodities were on the liberalized lists that had been set up under the OEEC's program, the Western German Government was committed to issuing licenses automatically for their importation. German importers, moreover, made some purchases in EPU countries of goods that were not actually produced there and that therefore should not have come under the liberalization procedure.

Table II
Western Germany's Foreign Trade by Areas
(In millions of dollars; including West Berlin)

Area	Imports		Exports		Balance	
	1950	1949	1950	1949	1950	1949
EPU countries.......	1,861.2	1,014.0	1,495.3	949.4	−365.9	− 64.6
Western Hemisphere..	626.0	993.5	266.3	84.4	−359.7	− 909.1
Other countries.......	216.7	229.2	219.0	89.2	+ 2.3	− 140.0
Grand total......	2,703.9	2,236.7	1,980.6	1,123.0	−723.3	−1,113.7

Note: + indicates export surplus; − indicates import surplus.
Source: *Monthly Report of the Bank Deutscher Laender*, December 1950, page 39.

Apart from the import boom and the deterioration in the terms of trade, Germany's foreign exchange position was further impaired, at least temporarily, by rumors last summer and fall of an impending upward revaluation of sterling; in consequence, many exporters delayed collection of their sterling bills, while importers made every effort to expedite payment of their liabilities to suppliers in the sterling area. Moreover, now that a sellers' market had returned, many foreign exporters who had previously been satisfied to ship to Germany on "cash against documents" terms began to demand payment by letter of credit from their German customers; this meant, in effect, that the latter had to pay for their imports long before arrival. German exports, it is true, also increased rapidly in the second part of 1950, but since they consisted largely of machinery and other industrial goods sold on credit, the proceeds were slow to appear in Germany's foreign exchange accounts. These various changes in the settlement of foreign trade transactions were of major importance in the rapid deterioration which took place in Germany's external accounts last year.

The German Government's indebtedness to the EPU increased by leaps and bounds, and by the end of November the cumulative deficit with the EPU had reached 324.2 million dollars, or 4.2 million in excess of Germany's quota under the EPU agreement. Under the quota arrangements, Germany was permitted to make use of EPU credit facilities only to the extent of 60 per cent (192 million dollars) of its quota, while the remainder had to be settled by means of gold or dollar transfers. By the time that the November deficit was settled, Germany had paid to the EPU 132.2 million dollars out of its foreign exchange reserves.

Confronted with this rapid drain of foreign exchange reserves and the approaching exhaustion of credit facilities with the EPU, the German Government had the problem of deciding whether it should redress the balance by abandoning or limiting the liberalization of imports and employing quantitative import restrictions, or whether it should curtail the demand for imports indirectly by tightening credit and increasing tax rates. Viewing direct economic controls with great distaste and believing that the balance-of-payments difficulties were essentially of a temporary nature, the government decided to rely primarily on financial measures. In this the government was also motivated by the consideration that, if it should resort to quantitative import restrictions, foreign countries were likely to retaliate by setting up higher barriers against German exports, with the result that it would soon be confronted with a new and equally large deficit at a lower level of total trade.

As a first step toward tighter credit conditions, Germany's central bank late in September increased the legal reserve requirements for commercial banks by 50 per cent for demand deposits and 100 per cent for time deposits. Since the commercial banks' portfolios were replete with rediscountable paper, however, this measure failed to reduce the credit volume. In October, the monetary authorities therefore decided to go one step further and restrict the credit facilities of the central banking system itself. This they did by refusing either to rediscount acceptances or to permit their use as collateral for credit extensions, unless the banks concerned agreed to restrict the volume of their acceptance credits, other than export credits, to specified levels. Finally, at the end of October, the central bank discount rate was increased from 4 per cent to 6 per cent in the hope that this would not only curtail the demand for credit but also lead to the liquidation of excessive credit-financed inventories. Credit volume continued to increase thereafter, but at a slower rate than during September and October.

In addition to reducing the availability and increasing the cost of central bank credit, the German authorities took a number of measures bearing directly upon the volume of imports. Early in October all outstanding licenses for liberalized imports that were not covered by contractual commitments were canceled. Subsequently, importers when applying for licenses were required to put up a cash deposit equivalent to 50 per cent (later reduced to 25 per cent) of the deutsche mark value of the underlying import orders. In addition, the authorities began to restrict somewhat the granting of licenses for nonliberalized imports and strengthened the controls over the use of export proceeds. None of these remedial measures, however, were expected by either the EPU or the German Government to bring Germany's external accounts immediately into equilibrium.

By early November, it had become obvious that unless Germany was granted additional credit facilities, direct controls of the most drastic nature, involving Germany's default on her liberalization commitments, would be required to rectify the deficit. The OEEC Council therefore decided to give help, and at its November 14 meeting it agreed in principle that the EPU should grant Germany a special 120 million dollar credit. Final approval of this credit was given in December, after the Council had been persuaded that the exhaustion of Germany's EPU quota was due to temporary causes that could be remedied with the aid of additional monetary and fiscal policy measures and without resort to quantitative import restrictions. The Council's conclusion was arrived at on the basis of two reports, one by the German Government and the other by two independent experts, Professor Alec Cairncross, Economic Adviser to the OEEC, and Dr. Per Jacobsson, Economic Adviser to the Bank for International Settlements, following an on-the-spot study of Germany's payments position. The German Government's report contained a detailed program for improving the country's balance of payments.

Under the OEEC's special credit plan, any indebtedness of Germany toward the EPU in excess of the German quota was to be met to the extent of two thirds out of the 120 million dollar credit, and to the extent of one third (i. e., up to 60 million dollars) by the payment of dollars out of German funds. The credit was to cover the period from November 1, 1950 to October 31, 1951, but it was to be reduced to 100 million dollars by the end of May 1951, and by 20 million each month thereafter. The German Government committed itself to keeping the OEEC informed of the measures it took to achieve the objectives of its economic program. The OEEC Council in turn recommended that all member countries adopt foreign trade policies conducive to the expansion of imports from Germany.

Contrary to the hopes entertained in the OEEC, Germany's accounts with the EPU continued to show substantial and increasing deficits, which necessitated utilization of the special credit at an alarming rate. In December, the deficit was 32.5 million dollars, in January it increased to 42.1 million, and in February it reached approximately 58 million. During the entire December-February period, the deficit thus averaged approximately 44 million dollars, monthly, against 65 million dollars during July to November. By the end of February, according to preliminary figures, Germany had already used up 91.4 million dollars of the 120 million dollar credit, and had lost an additional 45.7 million dollars to the EPU over and above the 128 million previously paid under the quota regulations. In consequence, Germany's credit facilities for March and April aggregated no more than 28.6 million dollars, an amount which, in the light of the extraordinarily large total of licenses issued during February for imports from the EPU area, appeared entirely inadequate.

Germany was thus rapidly approaching the day when it would have to pay its entire EPU deficit in dollars. In addition, it would soon have to begin repayment of the special 120 million dollar credit. If, moreover, one takes into account that ECA aid to Germany is likely to be cut sharply by next summer, the drastic nature of the limitations clamped on German imports in February need not evoke surprise. These restrictive measures may well have harmful effects not only on Germany's own economy but also on those of neighboring countries, especially Denmark, the Netherlands, and Switzerland. The German payments crisis thus transcends the comparatively narrow limits of an internal German problem and justifiably arouses concern as to its repercussions in the field of intra-European trade and payments.

A basic question is whether Western Germany can afford to return to the previously attained degree of import liberalization so long as the prevailing pressures toward an imbalance in its external accounts persist. Aside from the recent deterioration of Germany's terms of trade and the prospective tapering off of ECA aid, these pressures stem essentially from the still heavy needs for reconstruction and modernization of plant and equipment, and from the necessity to absorb millions of refugees and at the same time maintain living standards at a politically and economically tolerable level. Whatever the answer to this question, there is urgent need for additional German measures to mop up excessive purchasing power wherever it exists, and for a determined concentration of all available resources on the export drive. Even though the recent restrictive moves of the government are likely to go far toward checking the drain on the country's dollar reserves, more fundamental correctives than the present emergency measures would seem imperative if Germany is to achieve the needed basic readjustment in its international economic position.

SURVEY OF OWNERSHIP OF BUSINESS AND PERSONAL DEMAND DEPOSITS

Demand deposits of individuals, partnerships, and corporations in all commercial banks in the Second Federal Reserve District at the end of January 1951 are estimated to have increased to a record total of 21,985 million dollars, a figure 1,047 million dollars, or 5.0 per cent, above that of January 1950. The past year's expansion in this District compares with a rise of only 182 million dollars, or 0.9 per cent, in the previous year and is almost as large as the heaviest postwar increase, which occurred in 1947. Estimates of changes of ownership of deposits in this District during the past year have been made on the basis of reports from 117 banks that analyzed their larger accounts, and are part of the annual study conducted on a national scale by the Board of Governors of the Federal Reserve System.

The dominant cause of the increase in business and personal demand deposits during the year under review was the expansion of bank credit in the form of loans and bank holdings of securities other than those of the United States Government. The increase in loans occurred largely subsequent to the outbreak of hostilities in Korea and reflected advances to business concerns for building up inventories and enlarging productive capacity, and also advances to individuals for the purchase of residential real estate and consumers' durable goods. The expansion in loans and "other securities" and the accompanying rise in deposits represented a multiple expansion of commercial bank credit based upon reserves created through the sale of Government securities indirectly to the Federal Reserve System. It represented "deficit" spending by private groups as contrasted with the wartime deposit increases, which reflected "deficit" spending by the Government. The prospect of heavy Government expenditures for rearmament was, however, an important element in activating business and personal spending, even though in themselves Government fiscal operations were not instrumental in augmenting the money supply.

As the accompanying table indicates, all deposit ownership groups shared in the over-all rise in business and personal demand deposits in this District during the year ended January 31, 1951 (except in the case of nonprofit organizations, which declined 0.9 per cent). The largest relative gain (11 per cent) was shown by the "all other financial" group of accounts, which consists of investment, finance, real estate, and insurance agency firms, most of which were operating at relatively high levels during the past year. Cash balances in trust funds of banks increased by 10 per cent during the year and may have reflected, among a number of possibilities, uninvested accumulations in pension plan funds.

Among the nonfinancial business accounts, the increases ranged from 2.5 per cent in the accounts of retail and wholesale trade concerns and of dealers in commodities to 6.3 per cent in the accounts of manufacturing and mining concerns. The rise in balances in these accounts presumably reflected the increased working funds required for the production and distribution of a larger volume of goods and services at higher prices. Business firms tend to keep larger balances under these circumstances to meet higher payrolls, material costs, and taxes and also to carry any increase in the dollar volume of inven-

Estimated Ownership of Demand Deposits of Individuals, Partnerships, and Corporations in All Commercial Banks in the Second Federal Reserve District
(Dollar amounts in millions)

Type of owner	Dollar balance Jan. 1951	January 1950 to January 1951		July 1945 to January 1951	
		Dollar change	Per cent change	Dollar change	Per cent change
Manufacturing and mining	7,069	+ 417	+ 6.3	− 317	− 4.3
Public utilities, transportation, and communications	1,399	+ 41	+ 3.0	− 82	− 5.5
Retail and wholesale trade and dealers in commodities	3,251	+ 80	+ 2.5	+ 628	+23.9
All other nonfinancial business, including construction and services	1,416	+ 44	+ 3.2	+ 382	+36.9
Total nonfinancial	13,135	+ 582	+ 4.6	+ 611	+ 4.9
Insurance companies	1,087	+ 16	+ 1.5	+ 268	+32.7
Trust funds of banks	567	+ 52	+10.1	− 44	− 7.2
All other financial business*	1,616	+ 161	+11.1	+ 410	+34.0
Total financial	3,270	+ 229	+ 7.5	+ 634	+24.1
Nonprofit organizations	575	− 5	− 0.9	+ 138	+31.6
Personal (including farmers)	4,402	+ 224	+ 5.4	+ 917	+26.3
Foreign accounts	603	+ 17	+ 2.9	− 118	−19.6
Total demand deposits of individuals, partnerships, and corporations	21,985	+1,047	+ 5.0	+2,182	+11.0

* Includes investment, finance, real estate concerns, insurance agencies, etc.

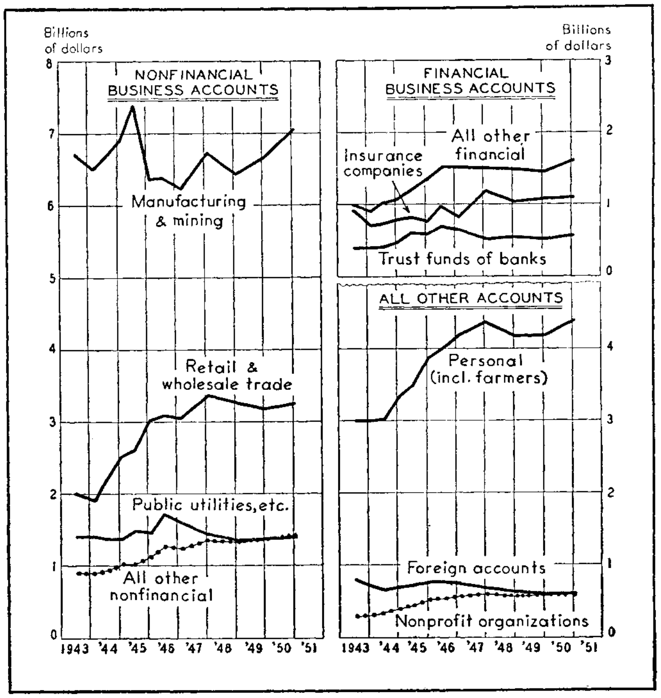
tories or receivables. The funds to accomplish this in the past year have been derived principally from depreciation and depletion reserves, by ploughing back a sizable portion of net profits, and by loans from banks.

Accumulations of funds in personal balances increased 5.4 per cent, with the rise confined to nonfarm accounts. Deposits of farmers, which are reported by the two smallest size groups of banks, moved irregularly but showed an aggregate decline of 9 per cent. Foreign balances recorded a modest rise of 2.9 per cent, the first to occur since 1946.

Estimates of deposit ownership in the different size groups of banks show that banks of all sizes shared in the past year's deposit gain, except that the group with total deposits of 1 to 10 million dollars sustained a minor over-all decline of ½ of 1 per cent. Personal accounts expanded in the banks of all size groups and, generally, the banks in which such accounts showed the largest relative gains had the largest over-all deposit increases. The financial group of accounts showed increases in the aggregate balances for each size bank, but the component elements (insurance company accounts, trust funds of banks, and "all other financial" accounts) moved irregularly within the various size groups. Among the nonfinancial business accounts, gains were shown in all ownership classifications in three size groups: the smallest banks (those with total deposits of less than 1 million dollars), the largest banks (those with total deposits in excess of 500 million dollars), and banks with deposits of between 10 and 100 million dollars. In the remaining groups of banks, irregular changes occurred in the nonfinancial business accounts. Banks with total deposits of 1 to 10 million showed an over-all net loss in nonfinancial business deposits of 2.8 per cent, while banks whose deposits totaled between 100 and 500 million showed a 2.4 per cent over-all gain in this type of account.

The accompanying chart shows the movements that have occurred in the balances of the various depositor groups since the surveys were first undertaken in July 1943. It is particularly noteworthy that, although the total volume of business and personal demand deposits attained a new high level by January 31, 1951, only three of the ten ownership groups also reached new peaks, namely, personal accounts, "all other nonfinancial" accounts, and "all other financial" accounts. The last two groups, although they are business accounts, are closely allied to personal checking balances in their behavior. They consist of the accounts of a variety of financial and non-

Estimated Ownership of Business and Personal Demand Deposits at All Commercial Banks in the Second Federal Reserve District*



* Figures are semiannual from July 1943 to February 1947 and annual as of each January thereafter.

financial service groups, whose personal and business funds are to a certain extent intermixed. They include, for example, the accounts of construction contractors, theatres and other places of amusement, laundries, automobile repair shops, brokers and dealers in securities, insurance agencies, real estate brokers, doctors, dentists, and lawyers. Deposit balances of retail and wholesale trade have also closely followed the trend in personal accounts over the years, but the upswing during the year under review was not sufficient to surpass the previous peak of January 1948. Balances held by manufacturing and mining and public utility concerns are determined principally by the amounts necessary to transact business, and uninvested idle balances are seldom accumulated in large amounts. The cash balances of insurance companies, and the trust funds of banks, also, are seldom left idle, and fluctuations are largely determined by the growth of the funds versus the availability of attractive investment outlets.

AUTOMATIC EXTENSION OF SERIES E BONDS

Automatic extension of United States Series E Savings bonds, which begin maturing on May 1, for another ten-year period became possible under a law signed by the President on March 26. Investors who choose to hold their maturing Series E bonds will receive accrued simple interest of 2.5 per cent, annually, for the first seven and one-half years of extended ownership, following which the interest rate will be stepped up to provide a yield of 2.9 per cent, compounded semiannually, if the Series E bonds are held for the remainder of the second ten-year period. The extended E bonds may be redeemed for cash at any time, as at present. No action is required of owners desiring to take advantage of the extension. Investors who prefer to receive current income semiannually are given the option of exchanging their maturing E bonds in amounts of $500, or multiples thereof, for 2.5 per cent 12-year Series G bonds bearing a special privilege of redemption at par (at any time beginning six months after issue date upon one calendar month's notice). A circular covering the exchange options is available at the Savings Bond Department, Federal Reserve Bank of New York, New York 45, New York.

EARNINGS AND EXPENSES OF THE SECOND DISTRICT MEMBER BANKS

Net profits of the Second District member banks, after all charges but before payment of dividends, amounted in the aggregate to 201 million dollars in 1950, compared with 165 million dollars in 1949, and were the highest since 1946, when 221 million was earned.[1] The bulk of the increase was concentrated in the central reserve New York City banks and in the largest-sized "reserve city" and "country" banks. In the remaining banks of the District, fluctuations in net profits from the 1949 level were small and irregular.

The rise in the net profits of the central reserve New York City banks—34 million dollars, or 30 per cent—was occasioned principally by higher net current operating earnings and reduced transfers to valuation reserves, offset in part by heavier income tax payments. Outside New York City, the amounts added to valuation reserves differed but little from those of the previous year, and in the final net profits of all groups of banks taken together, the fluctuations were determined by the movement of net current operating earnings in combination with higher taxes and reduced losses and charge-offs on loans.

[1] Net profits for the member banks in this District have been summarized in ratio form in Circular No. 3667, entitled "Operating Ratios of Member Banks in the Second Federal Reserve District for the Year 1950". Copies of this circular are available upon request from the Financial Statistics Division, Federal Reserve Bank of New York, New York 45, N. Y.

Total current operating earnings increased 7.9 per cent in the District as a whole, attaining a new high of 786 million dollars. In New York City the increase was 7.3 per cent, and in the remainder of the District it ranged from an average of 9.0 per cent in the largest banks to 2.8 per cent in the group of banks having total deposits of 2 to 5 million. The principal factor contributing to the higher gross income in all groups of banks was the enlarged loan income. This reflected the heavy expansion in the volume of loans which took place, mostly in the second half of 1950 following the outbreak of hostilities in Korea, and also the small rate increases later in the year which were part of the general hardening of the short-term money rate structure. Interest received on United States Government securities declined moderately in all groups of banks, as holdings were reduced in order to provide funds for loan expansion and for the additional reserves required against the enlarged deposit volume. Interest and dividends on "other securities", which consists largely of the tax-exempt obligations of State and local governments, increased considerably in the New York City banks and the largest out-of-town banks, but only to a minor extent in the other groups of banks. In the larger institutions—those with a capitalization in excess of $5,000,000—taxable incomes of a number of banks are either close to or in excess

Earnings and Expenses of Second District Member Banks for the Year 1950 and the Percentage Change from 1949
(Dollar amounts in thousands)

Item	Central reserve banks New York City (23 banks)		Reserve city and country banks, Deposit size: Over $20,000,000 (84 banks)		$5,000,000 to $20,000,000 (271 banks)		$2,000,000 to $5,000,000 (227 banks)		Under $2,000,000 (145 banks)		All member banks in Second District (750 banks)	
	Dollar volume 1950	Percentage change 1949 to 1950	Dollar volume 1950	Percentage change# 1949 to 1950	Dollar volume 1950	Percentage change# 1949 to 1950	Dollar volume 1950	Percentage change# 1949 to 1950	Dollar volume 1950	Percentage change# 1949 to 1950	Dollar volume 1950	Percentage change 1949 to 1950
Interest on United States Government obligations	144,644	− 2.3	40,816	− 3.9	23,417	− 3.9	6,625	− 5.9	1,723	− 6.2	217,225	− 2.3
Interest and dividends on other securities	31,251	+20.7	9,215	+ 13.8	4,766	+ 1.6	1,553	+ 0.1	412	+ 2.5	47,197	+17.0
Interest and discount on loans	215,111	+13.5	81,617	+ 16.6	42,461	+ 9.6	13,152	+ 8.0	3,837	+ 9.4	356,178	+14.4
Service charges on deposit accounts	16,315	+ 8.4	10,433	+ 10.0	6,936	+ 5.1	1,674	+ 3.2	386	+ 2.6	35,744	+ 9.1
Trust department income	57,484	+10.8	6,968	+ 9.9	1,442	+ 4.8	113	+ 3.7	2	(a)	66,009	+11.2
Other current income	47,347	+ 0.7	11,311	+ 5.7	3,815	− 1.6	1,001	+ 2.5	194	− 5.7	63,668	+ 2.2
Total current operating earnings	512,152	+ 7.3	160,360	+ 9.0	82,837	+ 4.0	24,118	+ 2.8	6,554	+ 3.5	786,021	+ 7.9
Salaries and wages—officers and employees	169,735	+ 3.0	52,680	+ 8.1	24,923	+ 4.1	7,187	+ 4.5	1,996	+ 7.7	256,521	+ 5.0
Interest on time and savings deposits	9,686	+23.4	16,187	+ 0.8	10,974	− 0.6	3,505	− 1.3	874	+ 0.4	41,226	+ 6.2
All other current expenses	118,440	+ 7.1	42,713	+ 8.5	20,446	+ 4.4	5,586	+ 4.3	1,493	+ 6.1	188,678	+ 8.0
Total current operating expenses	297,861	+ 5.2	111,580	+ 7.1	56,343	+ 3.3	16,278	+ 3.1	4,363	+ 5.6	486,425	+ 6.3
Net current operating earnings, before income taxes	214,291	+10.3	48,780	+ 13.7	26,494	+ 5.6	7,840	+ 2.1	2,191	− 0.5	299,596	+10.7
Security profits and recoveries (+) or charge-offs (−)*	+ 20,468	+70.3	+ 5,759	− 11.2	+ 887	− 30.3	+ 243	−28.3	+ 50	− 8.0	+ 27,407	+37.9
Net additions to (−) or deductions from (+) loan valuation reserves†	− 14,360	−52.4	− 8,179	− 2.8	− 3,049	+ 3.7	− 550	− 6.7	− 74	+39.6	− 26,212	−37.3
Net recoveries (+) or charge-offs (−) on loans	− 1,463	−75.2	− 578	− 76.9	− 234	− 63.5	− 211	−15.6	− 123	−22.5	− 2,609	−72.1
All other net recoveries (+) or charge-offs (−)	− 3,569	+12.2	− 448	+273.5	− 532	+186.4	− 23	−74.9	− 13	−34.8	− 4,585	+27.4
Taxes on net income	69,953	+26.3	13,709	+ 50.4	7,070	+ 16.2	1,725	+ 8.0	429	+ 7.1	92,886	+28.6
Net profits	145,414	+30.2	31,625	+ 8.1	16,496	− 0.1	5,574	+ 1.7	1,602	− 1.3	200,711	+22.8
Dividends paid	89,354	+ 8.5	12,401	+ 1.8	5,639	+ 8.5	1,690	+ 6.0	491	+10.6	109,575	+ 8.2
Retained earnings	56,060	+91.5	19,224	+ 12.7	10,857	− 4.0	3,884	0	1,111	− 5.8	91,136	+46.7

\# Since many banks shifted to a higher deposit size class in 1950, the percentage changes have been based on annual arithmetic averages per item for banks in each size classification. The number of banks shown in each column heading pertains to the year 1950.
* Also includes transfers to or from valuation reserves for losses on securities.
† Includes transfers to or from both bad debt and other valuation reserves for loan losses.
(a) Percentage change not shown—the dollar change being from a negligible amount.

of their excess profits tax base because they are not allowed so high a rate of return upon equity capital as the smaller banks. Consequently, the larger banks are more interested in tax-exempt securities. This interest is currently heightened by the additional tax increases under consideration by Congress. Receipts from service charges on deposit accounts and income from trust departments showed gains in the District as a whole of 9.1 per cent and 11.2 per cent, respectively, and in both instances the larger banks recorded the larger relative gains.

Total current operating expenses increased in all groups of banks. In the smallest institutions, those with deposits of less than 2 million dollars, the rise in expenses exceeded the rise in gross income, but elsewhere it was considerably less and a substantial margin was carried forward as increased net current operating earnings. Salary and wage payments were higher in all groups of banks, with the central reserve New York City banks showing a rise of 3.0 per cent compared with increases ranging from 4.1 per cent to 8.1 per cent in the reserve city and country groups of banks. Interest paid on time deposits rose substantially in New York City but showed only small and irregular fluctuations in the remaining Second District banks. In the City banks the increased interest payments were concentrated to a large extent in one of the largest institutions, which had established higher rates on compound interest accounts early in 1950. "Other current expenses", an item not much below salaries and wages in importance, rose 8.0 per cent in the District as a whole, and undoubtedly reflected in large part the rising costs of materials and supplies. One of the sizable components of this item, FDIC assessments, is expected to decline in 1951, as an amendment to the Federal Deposit Insurance Act on September 21, 1950 provided for substantial credits against future assessments.

Government security prices showed a generally declining tendency during 1950, and the volume of security profits, as well as recoveries on previously charged-off securities, tended to be lower. In the City banks this item was substantially higher than in 1949, but the increase arose entirely from the inclusion of substantial recoveries from valuation reserves for security losses by one of the largest banks, rather than from greater security profits or recoveries. Net additions to valuation reserves for loan losses receded sharply in New York City because many banks at the end of the previous year had already accumulated the maximum reserves for bad debt losses on loans allowable under the Treasury ruling of December 1947 (namely, three times the average loss experience of the past twenty years). The banks outside New York City, however, had not established tax-deductible reserves for bad debt losses on loans as quickly as the large City banks; thus the aggregate charges for this purpose showed only minor fluctuations in the three largest-sized groups of banks outside New York City and expanded sharply (40 per cent) in the smallest banks.

The improvement in business conditions between 1949 and 1950 was reflected in a substantial reduction in actual net losses and charge-offs on loans. Such charge-offs amounted to only 2.6 million dollars in the District as a whole, and relative to average outstanding loans they represented but a negligible fraction—less than one tenth of one per cent. The low loss ratio on bank loans leaves the reserves for bad debt losses on loans for many out-of-town banks at or near their ceiling, and for many banks the charges for additional accumulations in 1951 will probably decline from current levels.

Dividend payments, continuing the rise which has been going on steadily since 1943, increased 8 per cent over the 1949 level to a total of 110 million dollars. The bulk of the year's rise in net profits was added to capital funds, retained earnings rising from 63 million in 1949 to 91 million in 1950. In the past decade, net profits of the Second District member banks have amounted to 1,900 million dollars, of which 900 million, or 47 per cent, has been paid out as dividends while the remaining one billion has been added to capital funds, which have thus risen to three billion dollars. This capital addition compares with a capital reduction of 700 million during the decade of the thirties, when dividend payments were maintained at a reduced level despite deficit operation in a number of years and despite very low earnings in other years. The efforts of most bankers since 1941 to build up capital funds by the retention of earnings have been governed not only by the desire to restore the capital decline of the thirties but also to increase the margin of depositor protection, which the wartime expansion of deposits had reduced to record low levels.

SUBSCRIPTIONS TO MONTHLY REVIEW

The *Monthly Review of Credit and Business Conditions* is sent free of charge to anyone who is interested in receiving it. If you are not already on the mailing list and wish to receive the *Review* regularly, please write to the Domestic Research Division, Federal Reserve Bank of New York, New York 45, N. Y., and your name will be added to the mailing list.

The Federal Reserve Bank of New York also publishes an *Annual Report,* which appears usually in March or April. Upon written application to the Press and Circulars Division, the *Annual Report* will be sent without charge to those interested.

BANKING AND BUSINESS DEVELOPMENTS IN THE SECOND DISTRICT

A high degree of general business activity continues to prevail in those parts of the Second Federal Reserve District where calls were made by this bank's representatives during the past three months, according to the bankers interviewed. (Large New York City banks were not covered by this survey.) Industrial operations are active, with a growing shift to the production of defense goods as the volume of Government orders increases. This trend has resulted in expanded employment throughout all industrial areas visited. Retail trade in most areas has been more active than during the same period a year ago. Aside from the usual seasonal demands, there was some scare buying in January, because of the fear that shortages of consumer goods might appear as the year advanced. In this connection, bankers in some sections indicated that retail inventories had been built up in anticipation of such a development.

Home building in most sections has been in somewhat reduced volume during the past few months, as is usual during the winter season. In certain areas, activity was reported to be less than a year ago, but in other areas home building continued at high levels under financing commitments made prior to the October regulations. The outlook for the balance of the year is said to be somewhat confused because of uncertainties with respect to the availability of building materials and supplies (in view of Government defense needs) and because of the effect Regulation X and allied regulations may have on the future market.

In the Western New York fruit belt, bankers reported that many farmers are gradually shifting to dairying as a means of stabilizing income. For the last several years income from fruit has been unsatisfactory, since high yields have been neutralized by low prices. The stiffening of milk prices is reported to have done much to improve farm incomes.

Loan totals of the banks visited showed an upward trend. The largest gains were in mortgage accounts and in business loans for production and inventory purposes. Some of the bankers pointed out that among the factors influencing the increased demand for business loans were the rise in prices for raw and finished products, increased industrial activity, and prompter billings and deliveries than anticipated. Bankers said that, while there had been some seasonal slowing down in the demand for mortgage money, the substantial amount of commitments made prior to the effective date of Regulation X, plus expected new spring business, would tend to hold mortgage demand up until well along in the summer. The demand for consumer loans is easing slowly as the restraints under Regulation W take hold. This development is gradually being reflected in a stabilization or decline of instalment loan totals in many of the banks.

Deposit trends vary. Many banks reported increases in their demand deposits, but others indicated no appreciable change or some decline. Time deposits of the commercial banks in general are slowly decreasing, especially in areas where there are other types of financial institutions offering higher rates of interest. There is, however, little inclination on the part of commercial bankers to increase interest rates paid on savings deposits, in the light of present economic conditions and of the uncertainty of future earning power. Most of these banks seem content to retain their present rate (generally 1 per cent) regardless of the trend of their time deposits.

The investment positions of the banks visited showed little or no change in recent months. Although total holdings of Government securities have declined, there has been a tendency to stick closely to the same relative composition of the portfolio. Some banks have shown increasing interest in tax-exempt municipal securities.

One of the newer developments in banking is the establishment of drive-in windows for depositors' convenience, especially in some of the larger cities. Such facilities have become increasingly popular, especially where traffic congestion and parking problems prevent easy access to regular banking facilities. A desire to render better service over a wider area, as well as competition for business, appears to foster continued interest in branch banking within the limited areas where it is permitted by law.

THE CONSUMERS' PRICE INDEX[1]

The sharp rise in prices resulting from the Korean conflict and from the sudden enlargement of this country's defense program, together with the increased use of the consumers' price index as a basis for determining wage adjustments, has heightened public interest in the index in recent months. In order to improve this important price indicator, the U. S. Bureau of Labor Statistics recently published an interim revision of it, pending a more thorough overhaul.

The consumers' price index measures changes, as of the fifteenth of each month, in the cost of a fixed "market basket" of goods and services representative of the expenditures of moderate-income families in large cities. It does not measure changes in the actual amount spent for all living expenses. Originally the index was computed on the basis of the expenditure pattern of moderate-income families in 1917-19. In 1940, however, the series was revised, and the selection of goods for the sample to be priced each month and the relative weights given to these goods in compiling the index were determined on the basis of a detailed study of actual expenditures made by moderate-income families in the period 1934-36.

[1] This is the second in a series of articles describing various items in the table of Business Indicators.

Consumers' Price Index for Moderate-Income Families
(1935-39 average = 100 per cent)

Month		United States		New York City	
		Old series	Adjusted series*	Old series	Adjusted series*
1950	January	166.9	168.2	163.7	164.8
	February	166.5	167.9	163.7	165.1
	March	167.0	168.4	164.0	165.5
	April	167.3	168.5	164.5	165.9
	May	168.6	169.3	165.4	166.1
	June	170.2	170.2	167.0	167.0
	July	172.5	172.0	170.0	169.8
	August	173.0	173.4	168.0	169.7
	September	173.8	174.6	170.3	171.7
	October	174.8	175.6	171.0	172.4
	November	175.6	176.4	172.1	173.2
	December	178.4	178.8	175.1	175.4
	Average	171.2	171.9	167.9	168.9
1951	January	181.6	181.5	177.7	177.8
	February	184.2	183.8	180.8	180.8

* Adjusted for "new unit bias" in rents and based on expanded coverage and revised weights.
Source: U. S. Bureau of Labor Statistics.

Currently around 200 items are priced each month. They have been chosen not only because of their own importance in the family budget, but also because they are considered representative of a larger group of related items. The actual prices paid by consumers for the goods included in the sample are obtained from month to month as long as such items are available in retail stores. Whenever a selected item disappears from the market, it is replaced by one as nearly comparable as possible; for instance, in 1946 nylon stockings were substituted for rayons, which had previously replaced silk stockings.

The consumers' price index for the United States is the average of the indexes of selected large cities (including New York City). Indexes are determined for each of 34 major cities from the change in the cost of a "market basket" of goods representative of the city's own particular expenditure pattern. The city indexes are combined into a national average by weights based on the population of each city and of other cities in the same region of the same size class.

The index is prepared by the Bureau of Labor Statistics of the United States Department of Labor, and runs back to 1913.[2] Both the composite index and the figures for its major components—food; apparel; rent; fuel, electricity, and refrigeration; housefurnishings; and miscellaneous[3]—are published for the most recent thirteen or more months in each issue of the *Monthly Labor Review* of the Department of Labor and the *Federal Reserve Bulletin* of the Board of Governors of the Federal Reserve System.

In computing these index numbers, the Bureau of Labor Statistics takes the average for the years 1935 through 1939 as 100 per cent. That is to say, the consumers' price index in any given month is equal to the ratio of the cost of the specified "market basket" in that month to the cost of the same "market basket" in the 1935-39 period. No adjustments for seasonal variations are made.

Since the index is designed as a measure of price changes for a fixed quantity of goods, rather than of changes in the standard of living, its name was changed in 1945 to "Consumers' Price Index" from the original name, "Cost-of-Living Index". For one thing, it does not reflect the effect of income taxes on the standard of living. Moreover, the index cannot take full account of the fact that over extended periods the expenditure patterns of families change as some goods go out of fashion or disappear from common use, as others assume new importance in the family budget, and as new items gain popular acceptance. Also, the long-term growth in real income causes the relative importance of necessities and luxury items in the family budget to change. To correct for changes in expenditure patterns since the 1934-36 survey, the Bureau of Labor Statistics has undertaken a complete revision of the index, which it expects to complete late in 1952. As a result of the study, the content of the "market basket" and the weights of the selected items will be revised and modernized. A greater number and variety of cities will be covered, and methods of collecting price information will be improved.

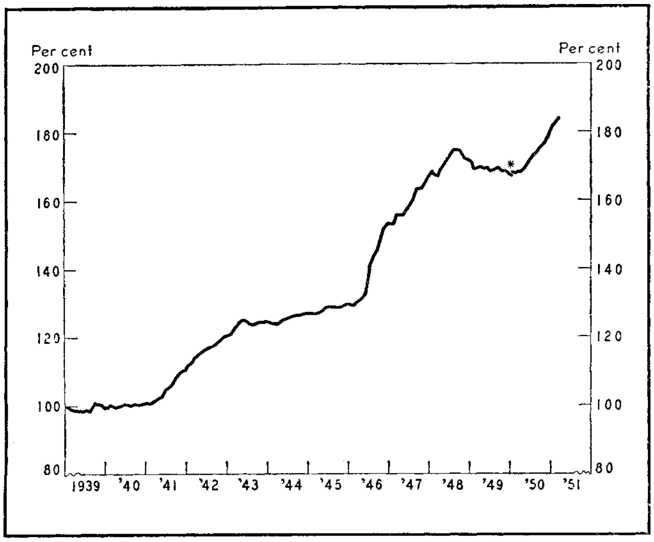
The defense program, however, has caused an immediate need for the best available measure of consumers' prices for use in wage and price stabilization. Therefore, an interim revision of the index, based upon the work completed to date, has been made, eliminating some of the more obvious distortions of the old index without changing its basic scope and concept. The new index is available for the months beginning with January 1950. The unrevised index will be computed concurrently with the new one throughout 1951. In this issue of the *Monthly Review,* the new index is reported in the table of Business Indicators for the first time. The old and new series for the United States and for New York City are compared in the accompanying table.

A long-recognized shortcoming of the old index was its understatement of the increase in rents as a result of its failure to reflect the effect of the higher rents charged for new dwellings when these are first rented. The new index allows for the higher than average initial rentals of the increasing number of new dwellings. The coverage of the adjusted consumers' price index has also been expanded to include some 30 new items, such as frozen foods, gas for househeating, television, and group hospitalization, which have become important in the family budget since the mid-1930's. The weighting of the components has been adjusted in the new index in accordance with the results of studies of expenditures conducted by the

[2] The index has been computed monthly since September 1940. Prior to that time it was computed, in general, on a quarterly, semiannual, or (in the case of the earliest years) annual basis. The Federal Reserve Bank of New York has compiled a continuous monthly composite index, beginning January 1913, by estimating monthly indexes between BLS survey dates on the basis of cost-of-living data from other sources. Tabulations are available from the Domestic Research Division on request.

[3] The miscellaneous group includes medical care, drugs, household operation, recreation, tobacco, personal care, transportation, etc.

Consumers' Price Index
(1935-39 average = 100 per cent)



* Series adjusted and revised from January 1950 to date.
Source: U. S. Bureau of Labor Statistics.

Bureau of Labor Statistics in seven cities since 1947. For example, the relative importance of expenditures for food as of January 1950 was lowered to 33 per cent of the family budget, compared with 42 per cent in the old index. The weight given to shelter was also lowered. As incomes of wage earners have risen, expenditures for items other than necessities have tended to be relatively greater than formerly. The population weights used to combine the individual city indexes have been brought up to date by use of the 1950 Census of Population. Since the various adjustments tended to offset one another, changes in the composite index were small. A detailed discussion of this interim revision is scheduled to appear in the April 1951 issue of the *Monthly Labor Review.*

The accompanying chart shows the changes in consumers' prices since January 1939. Since the beginning of 1950, the index has been rising, and since last July the month-to-month increases have been sharp. By February of this year, consumers' prices as measured by the index had reached a record high of 183.8 per cent of the 1935-39 average, and were 8 per cent greater than in June 1950.

DEPARTMENT STORE TRADE

Matters which have recently become of major concern to department store executives are the plentiful supply of merchandise which the stores have in stock and on order, and what appears to be a decided slackening of consumer demand.

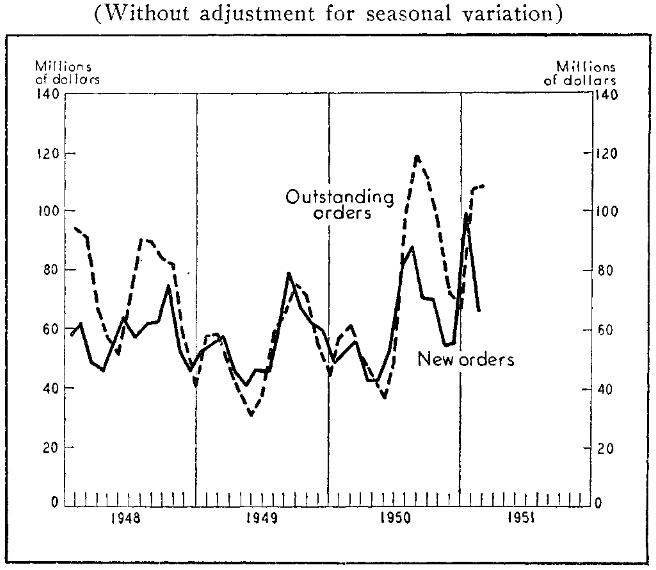
At the end of February, more than eight months after the start of the Korean war, the department stores of this District had more stock on hand (after allowance for seasonal variation) than at any other time on record. On the other hand, the dollar volume of average daily sales, while almost 20 per cent greater than during February 1950, was markedly below the extraordinarily high level of the previous month. Furthermore, according to preliminary information, department store sales in this District during March did not come up to seasonal expectations. Average daily sales in March are estimated to have been only about 4 per cent above the February level and 8 per cent higher than those of March 1950, despite the fact that Easter occurred two weeks earlier this year.

The major reasons for the general inventory buildup that has taken place since last summer were the expectation of a general rise in prices and the anticipated further expansion of retail activity. On the other hand, production of consumer goods, particularly durables, was expected to be progressively curtailed as the rearmament program gained momentum. So far, however, the transition to a defense economy has not made serious inroads into the production of consumer goods, whether durables or nondurables. In fact, manufacturers and suppliers have been able to deliver goods to the stores at an even faster rate than the public purchased them. An additional factor in the inventory buildup is the time lag between the placing of orders and the actual delivery of the goods, which frequently results in the stores' achieving their greatest inventory accumulation some weeks after the highest relative level of consumer demand has been reached.

As the chart shows, in February the stores took an initial step toward keeping inventories more closely geared to sales by reducing contraseasonally the value of new orders well below the level of the preceding month. More extensive advertising or an increase in promotions may follow, depending, of

Dollar Volume of New and Outstanding Orders at Second District Department Stores, 1948-February 1951*

(Without adjustment for seasonal variation)



* For a group of stores whose 1950 sales were more than half of the estimated Second District total. Outstanding orders are end-of-month data, new orders are monthly totals.

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

Item	1951		1950	
	Feb.	Jan.	Dec.	Feb.
Sales (average daily), unadjusted	218	233	450	184r
Sales (average daily), seasonally adjusted	263	291	266	222r
Stocks, unadjusted	273	240	239	218r
Stocks, seasonally adjusted	281	273	263	225r

r Revised.

course, on how well the sales volume holds up later in the spring.

The fact that outstanding orders at the end of February were virtually unchanged (there was actually a very slight increase), after a sharp cutback in new orders during the month, is partially explained by the composition of the orders still to be filled. The bulk of the orders outstanding, in terms of dollar value, are for major household durables (which are not greatly affected by seasonal demand patterns) and are, in many cases, relatively long-term commitments. The wide divergence of movement between new orders and outstanding orders which prevailed during most of 1948 and the latter half of 1950 was also indicative of a large carry-over of orders for durable goods, due principally to extended delivery schedules.

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

Locality	Net sales		Stocks on hand Feb. 28, 1951
	Feb. 1951	Jan. and Feb. 1951	
Department stores, Second District	+19	+25	+26
New York City	+19	+24	+29
Northern New Jersey	+21	+29	+21
Newark	+21	+29	+20
Westchester County	+21	+27	+ 8
Fairfield County	+15	+28	+27
Bridgeport	+16	+29	+29
Lower Hudson River Valley	+12	+20	+20
Poughkeepsie	+12	+20	+22
Upper Hudson River Valley	+21	+31	+22
Albany	+30	+39	+24
Schenectady	+12	+23	+23
Central New York State	+16	+25	+26
Mohawk River Valley	+18	+25	+27
Utica	+ 9	+16	+30
Syracuse	+16	+25	+25
Northern New York State	+14	+24	+17
Southern New York State	+22	+32	+12
Binghamton	+17	+28	+ 6
Elmira	+39	+47	+29
Western New York State	+14	+22	+26
Buffalo	+11	+20	+33
Niagara Falls	+25	+28	+23
Rochester	+17	+23	+14
Apparel stores (chiefly New York City)	+15	+19	+19

Business Indicators

Item	Unit	1951		1950		Percentage change	
		February	January	December	February	Latest month from previous month	Latest month from year earlier
UNITED STATES							
Production and trade							
Industrial production*	1935-39 = 100	221p	221	218r	180	0	+23
Electric power output*	1935-39 = 100	322	318	316	277	+ 1	+16
Ton-miles of railway freight*	1935-39 = 100	186p	208p	205	141r	−11	+32
Manufacturers' sales*	billions of $	—	23.3p	21.3	16.9	+ 9	+44
Manufacturers' inventories*	billions of $	—	34.9p	34.0	29.0	+ 3	+20
Manufacturers' new orders, total	billions of $	—	26.5p	23.1	16.9	+15	+56
Manufacturers' new orders, durable goods	billions of $	—	13.1p	11.1	7.2	+18	+75
Retail sales*	billions of $	12.9p	13.3	12.2	11.1	− 3	+16
Residential construction contracts*	1923-25 = 100	326p	312	297r	260	+ 4	+25
Nonresidential construction contracts*	1923-25 = 100	344p	350	360r	266	− 2	+29
Prices, wages, and employment							
Basic commodity prices†	Aug.1939 = 100	390.2	383.9	358.9	247.8	+ 2	+57
Wholesale prices†	1926 = 100	183.6p	180.1	175.3	152.7	+ 2	+20
Consumers' prices†**	1935-39 = 100	183.8	181.5	178.8	167.9	+ 1	+ 9
Personal income* (annual rate)	billions of $	—	239.2p	241.0	215.4	− 1	+11
Composite index of wages and salaries*	1939 = 100	—	219p	216	204	+ 1	+ 7
Nonagricultural employment*	thousands	45,980p	45,810	45,607r	42,283	#	+ 9
Manufacturing employment*	thousands	15,937p	15,836	15,686r	14,023	+ 1	+14
Average hours worked per week, manufacturing†	hours	41.0p	41.0	41.4	39.7	0	+ 3
Unemployment	thousands	2,407	2,503	2,229	4,684	− 4	−49
Banking and finance							
Total investments of all commercial banks	millions of $	71,480p	72,360p	74,720p	77,470	− 1	− 8
Total loans of all commercial banks	millions of $	53,730p	52,890p	52,830p	43,130	+ 2	+25
Total demand deposits adjusted	millions of $	91,200p	92,100p	93,200p	84,500	− 1	+ 8
Currency outside the Treasury and Federal Reserve Banks*	millions of $	27,145	27,222	27,531	27,008	#	+ 1
Bank debits* (U. S. outside New York City)	billions of $	84.4	87.8	77.1	68.2	− 4	+24
Velocity of demand deposits* (U. S. outside New York City)	1935-39 = 100	100.5	102.8r	98.6r	88.3	− 2	+14
Consumer instalment credit outstanding†	millions of $	—	13,255p	13,467	10,884	− 2	+22
United States Government finance (other than borrowing)							
Cash income	millions of $	4,918p	4,696	4,488	3,595	+ 5	+37
Cash outgo	millions of $	3,563p	3,438	4,004	3,537	+ 4	+ 1
National defense expenditures	millions of $	1,938p	1,869p	1,679	1,005	+ 4	+93
SECOND FEDERAL RESERVE DISTRICT							
Electric power output* (New York and New Jersey)	1935-39 = 100	128	126	124	113	+ 2	+13
Residential construction contracts*	1923-25 = 100	—	213p	161	166	+33	+32
Nonresidential construction contracts*	1923-25 = 100	—	232p	198	187	+17	+21
Consumers' prices†** (New York City)	1935-39 = 100	180.8	177.8	175.4	165.1	+ 2	+10
Nonagricultural employment*	thousands	—	7,264.2p	7,235.9	6,898.9	#	+ 6
Manufacturing employment*	thousands	2,661.6p	2,635.6	2,615.2	2,398.0	+ 1	+11
Bank debits* (New York City)	billions of $	43.4	46.4	43.5	39.7	− 6	+ 9
Bank debits* (Second District excluding N. Y. C. and Albany)	billions of $	3.8	3.9	3.2	2.9	− 4	+28
Velocity of demand deposits* (New York City)	1935-39 = 100	110.8	115.2r	114.8r	105.8	− 4	+ 5

p Preliminary. r Revised.
* Adjusted for seasonal variation. † Seasonal variations believed to be minor; no adjustment made. ** Revised series; see accompanying article.
# Change of less than 0.5 per cent.
Source: A description of these series and their sources is available from the Domestic Research Division, Federal Reserve Bank of New York, on request.

NATIONAL SUMMARY OF BUSINESS CONDITIONS

(Summarized by the Board of Governors of the Federal Reserve System, March 29, 1951)

Industrial output and employment were maintained at advanced levels in February and early March. Retail sales declined from the record January rates and business inventories rose further. Bank loans to business continued to expand rapidly. Wholesale commodity prices showed little further rise. Bond yields increased following announcement of a new Treasury offering.

Industrial Production

The Board's seasonally adjusted index of industrial production was maintained in February at the advanced January level of 221 per cent of the 1935-39 average. March output was apparently at or slightly above this rate, which is about 20 per cent above year-ago levels and 11 per cent higher than in June 1950.

Output of durable manufactures rose somewhat further in February and early March. Steel output, which was reduced in early February as a result of the rail strike, subsequently advanced to a new record rate. With capacity expanding, aluminum production rose further in February to a rate 11 per cent higher than in mid-1950. Auto assembly since mid-February has been not far below the highest 1950 rate. Activity in other transportation equipment and in machinery industries has continued to increase, as a result of the record rate of orders for producers' equipment and the rapidly growing volume of defense orders. Output of household durable goods and building materials has continued in very large volume.

Production of nondurable goods has apparently declined slightly from the new record level reached in January, reflecting mainly the curtailment in wool textile output as a result of work stoppages beginning February 16. Cotton textile mill activity rose considerably in February to about the earlier record rate reached in 1942. Output of paper and paperboard has reached new peak levels. Production of manufactured foods and most other nondurable goods has been maintained in large volume.

Minerals production declined in February owing largely to the rail strike. In early March production of coal and crude petroleum increased somewhat.

Employment

Employment in nonagricultural establishments, seasonally adjusted, has continued to expand moderately and in February was at a new record of 46 million. Hours of work in manufacturing remained at the January average of 41 per week, more than one hour above a year ago; average hourly earnings rose moderately in February to a new high of $1.56. Unemployment at 2.4 million was at the lowest level recorded for this month in the past five years and a further decline is indicated in March.

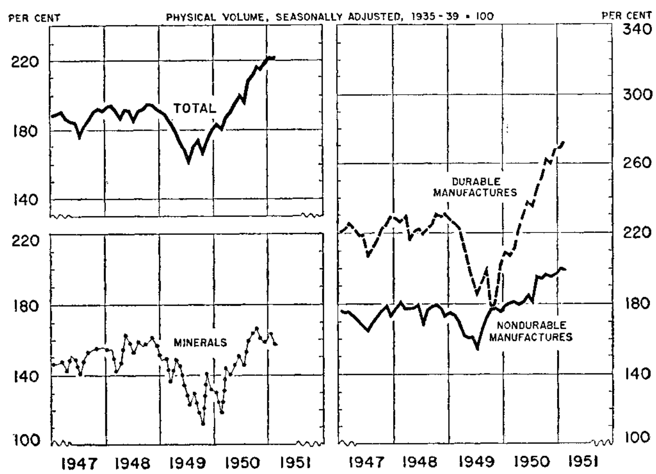
Construction

Value of construction contract awards increased by almost 10 per cent in February and has continued to rise seasonally in March. The total value of work put in place in February also increased further, after allowance for seasonal influences, reflecting increases in all types of private construction activity. The number of housing units started was 80,000 as compared with 87,000 in January and 83,000 in February 1950.

Distribution

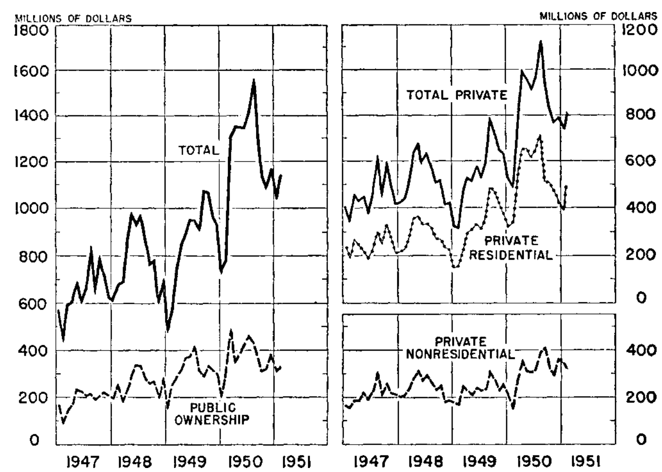
Retail sales of automobiles and most other goods have been at high levels in February and March. Sales of apparel and of

INDUSTRIAL PRODUCTION



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

CONSTRUCTION CONTRACTS AWARDED



F. W. Dodge Corporation data for 37 Eastern States. Monthly figures; latest shown are for February.

housefurnishings, however, have declined substantially from the record January levels, after allowing for seasonal influences. The Board's seasonally adjusted index of value of sales at department stores decreased from 362 in January to 325 in February and in March has declined further. At the end of February, value of department store inventories was more than one-fourth larger than on the same date in 1950, with stocks of television sets and some other goods reported to be especially ample.

Commodity Prices

The wholesale price level has shown little further advance since mid-February. Increases have been permitted in Federal ceiling prices for automobiles and carpets, while prices of some materials have receded from earlier peaks.

Consumer prices advanced 1.3 per cent further in February. Retail food prices increased 2 per cent to a level 16 per cent above a year ago.

Bank Credit

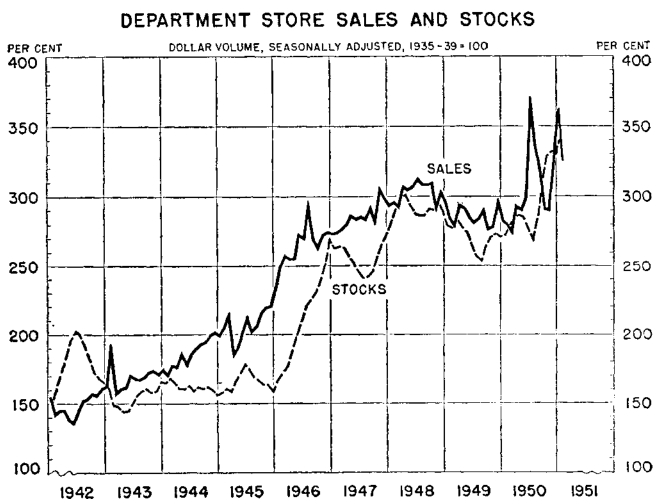
Business loans continued to expand rapidly during February and the first half of March. At this season of the year, business loans usually decline. Real estate loans and bank holdings of corporate and municipal securities also rose moderately.

The privately held money supply was about as large in mid-March as in early February. The continuing private credit expansion tended to increase the supply but this effect was about offset by tax payments and further gold outflow.

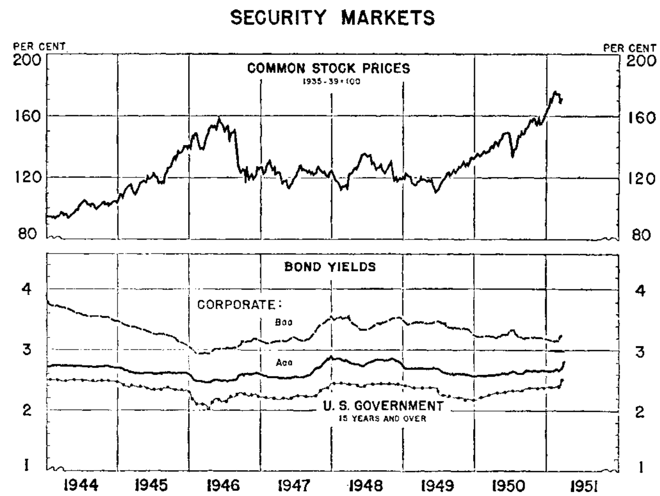
Bank reserves increased from early February through mid-March, reflecting in part substantial Federal Reserve purchases of Government bonds.

Money Rates and Security Markets

Interest rates rose somewhat further in March. On March 8, the Secretary of the Treasury offered holders of the 2½ per cent bonds of June and December 1967-72 the privilege of conversion into a new nonmarketable 2¾ per cent bond maturing April 1, 1980 and callable on April 1, 1975. The new bond will be exchangeable at the option of the owner into marketable 5-year 1½ per cent Treasury notes to be dated April 1 and October 1 of each year. Following the announcement yields increased on medium and long-term Treasury securities and corporate and municipal bonds. Later in the month yields on short-term Treasury issues rose somewhat. Rates charged borrowers on prime commercial paper and on bankers' acceptances increased by ⅛ of a percentage point.



Federal Reserve indexes. Monthly figures; latest figure for sales is February; latest for stocks is January.



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