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MONEY MARKET IN MAY

The money market was tight through most of the past month as routine money market transactions absorbed bank reserve funds on balance and the security operations of the Federal Reserve System took approximately 650 million dollars out of the market. As a reflection of this tightness, the banks increased the frequency and volume of their borrowing from the Reserve Banks. Although bank sales of short-term Treasury securities were also substantial, the absence of Federal Reserve buying (net) meant that the banks could only obtain a moderate amount of free reserves through these sales. As a result, for the final third of the month aggregate excess reserves were drawn down, and held, at levels considerably below the working minimums of recent years.

Two Treasury announcements during the month had some influence on money market developments. On May 8 the Secretary of the Treasury announced that the 2 per cent bonds of September 15, 1951-53 would not be called at this time; but there was little adverse market reaction, partly because the market had to some extent anticipated this decision, and partly because the Secretary simultaneously announced the offering of a new series of Tax Savings notes, beginning May 15, at rates of interest roughly 7/16 of one per cent above those previously prevailing on such notes, which was interpreted to imply that no further material change in short-term rates was expected in the near future. The second major announcement came on May 28, when the Secretary released the terms on the ten billion dollars of refinancing due June 15 and July 1. A 9½-month, 1⅞ per cent Treasury certificate of indebtedness, dated June 15, will be offered in exchange for the 1.6 billion dollars of 2¾ per cent Treasury bonds of June 15, 1951-54 and the 8.4 billion dollars of 1¼ per cent Treasury notes maturing on July 1. These terms compared favorably with those on outstanding issues of comparable maturity and investors apparently consider them attractive.

GOVERNMENT SECURITY MARKET

The brunt of the stringency in money market conditions was centered in the Treasury bill market. A reduction in

System bill holdings of 730 million dollars of bills during the five weeks ended May 29 was augmented by sizable commercial bank sales and redemptions, principally in the week ended May 9. The combined pressure brought about an increase in bill yields in the first half of the month, from about 1½ per cent on the outstanding issues at the beginning of May to 1.65 per cent at the peak on May 14. The strain on the bill market and on other short-term Treasury securities was softened by substantial nonbank investor demand and by the increased readiness of the banks to borrow from the Reserve Banks in adjusting reserve positions. Yields fell after the middle of the month as a result of net market demand.

Toward the close of the month, short-term Treasury security yields moved irregularly, reflecting the influence of the Treasury's refunding offering. The called and maturing issues moved down in yield (up in price) and acquired "rights values" in early trading on May 29, the day the announcement appeared in the press. The higher quotations induced moderate selling of the "rights" by those investors who elected to do their refunding in the market and by other investors in need of cash to meet previous commitments. Some commercial banks adjusting their reserve positions also sold the "rights" rather than sell other short-term Government securities at a loss. A large part of the proceeds of such sales was reinvested in short-term issues. Yields on Treasury bills consequently fell further in the last two trading days of May, almost to the levels prevailing at the end of April. Yields on Treasury notes

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maturing through November 1 moved slightly higher and then receded. Yield and price movements of other classes of Government securities apparently were not directly affected by the new financing.

In the market for medium and longer-term Treasury bonds, yields rose (prices fell), continuing the trend which had begun in February and had been interrupted by a short-lived recovery of prices in April. The Treasury's decision not to call the 2 per cent bonds of September 1951-53, although partly discounted in the market, nonetheless encouraged some further selling of Treasury bonds and contributed to a moderate easing of prices. At the low point on May 15, prices of Victory bonds were 10/32's below the preceding low on April 19 and 25/32's below the peak of the subsequent recovery reached on April 26. Other restricted bonds showed somewhat smaller declines. Revealing the pressure on bank reserve positions, and current developments in the short-term market, the longest maturing eligible bonds experienced wider losses.

With the easing of the money market for a few days after the middle of the month, prices of ineligible bonds improved slightly, aided by short covering on the part of professional traders. As the date for the announcement of the Treasury's forthcoming financing approached, prices also rose in response to traders' expectations that the market would be held stable in preparation for and during the refundings. The advance after the middle of the month was small, ranging from 3/32's to 6/32's for most ineligible bonds and the longest-term bank eligible issue, and at the end of the month the market was quiet and steady. Recovery in partially tax-exempt issues, which moved somewhat more irregularly than the other classes of bonds, was likewise small.

The declines in prices of medium and long-term eligible and restricted bonds between the end of April and the end of May were the smallest in recent months. This relative stability of prices was accompanied by a substantial reduction in Federal Reserve purchases of Treasury bonds which aggregated 150 million dollars in the five weeks ended May 29, as compared with 540 and 640 million dollars in the four weeks ended April 25 and March 28, respectively.

MEMBER BANK RESERVES

As shown in the accompanying table, routine money market transactions, principally a midmonth increase in Federal Reserve "float", made moderate amounts of reserve funds available to the banks in the three weeks ended May 16. But these gains of funds were greatly exceeded by losses stemming from the substantial contraction of Federal Reserve credit, and in the last half of the month the routine operations themselves caused a further drain on reserves. In the three weeks ended May 16, Federal Reserve System holdings of Treasury bills declined 575 million dollars. The impact of this decline

on reserve positions was softened by the demand of nonbank investors for bills, thereby bringing about a reduction of deposits and lowering of required reserves, particularly in the week ended May 9.

With the System reducing its holdings of Treasury securities, the banks found it was not feasible to adjust their reserve positions fully by selling short-term Treasury issues in the open market. These could only be absorbed by nonbank investors and would provide free reserves only to the extent of the lowering of required reserves resulting from the reduction in nonbank investors' deposits. Thus, the sales of Treasury securities to nonbank investors yielded free reserves equal only to a fraction of the volume of sales. Nonetheless, the weekly reporting member banks did dispose of sizable amounts of Government securities in the three weeks ended May 16, principally in the week ended May 9. Sales of securities by the banks, however, were no larger than the increase in their borrowings, which thus became a major channel through which reserve positions were adjusted. The banks, furthermore, borrowed more frequently than in the past, expanding their use of Federal Reserve advances in most cases when sizable losses of reserves occurred and reducing these advances whenever the accretion of funds permitted. Member bank borrowing rose by nearly 400 million dollars in the three weeks ended May 16 to more than 540 million dollars, as indicated in the chart on the next page. Excess reserves rose about 115 million dollars in this period.

Although routine transactions, especially the customary sharp drop in the float after the middle of the month, absorbed a moderate amount of reserve funds in the following week ended May 23, money market conditions nevertheless eased as the Treasury made net disbursements early in the week and the loss of reserves came late in the week. The rate on Federal funds fell below one per cent in the early part of

**Weekly Changes in Factors Tending to Increase or Decrease
Member Bank Reserves, May 1951**
(In millions of dollars; (+) denotes increase
(—) decrease, in excess reserves)

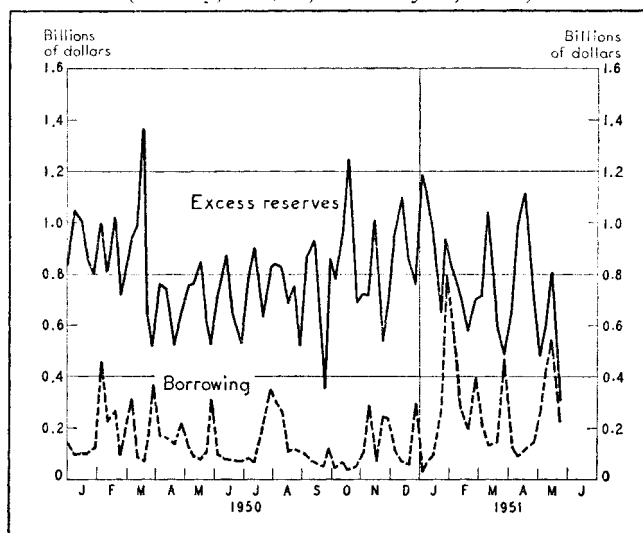
Factor	Statement weeks ended					Five weeks ended May 29
	May 2	May 9	May 16	May 23	May 29	
<i>Routine transactions</i>						
Treasury operations*.....	- 25	- 64	+ 23	- 13	+135	+ 56
Federal Reserve float.....	+ 44	- 3	+233	-202	-226	-154
Currency in circulation.....	-133	- 60	+ 28	+ 36	-210	-339
Gold and foreign account...	- 69	+ 15	- 17	+ 27	- 11	- 55
Other deposits, etc.....	+ 59	+ 17	- 1	- 15	+ 30	+ 90
Total.....	-124	- 95	+266	-166	-282	-401
<i>Federal Reserve transactions</i>						
Government securities.....	-224	-172	-147	+ 16	-120	-647
Discounts and advances.....	+115	+157	+120	-316	+312	+388
Total.....	-110	- 14	- 27	-300	+192	-259
<i>Total reserves.....</i>	-234	-109	+239	-466	- 90	-660
<i>Effect of change in required re- serves.....</i>	+ 21	+226	- 28	- 39	+ 66	+246
<i>Excess reserves.....</i>	-213	+117	+211	-505	- 24	-414

* Includes changes in Treasury currency and cash.
Note: Because of rounding, figures do not necessarily add to totals shown.

the week, having been above 1½ per cent during most of the preceding three weeks, but it rose again to over one per cent by May 23. The commercial banks, principally those outside New York City, drew heavily upon excess reserves to meet their reserve losses and to pay off about 315 million dollars of their indebtedness to the Reserve Banks in the week ended May 23, paving the way for tighter money market conditions in the remainder of the month. Excess reserves declined over 500 million dollars in the week to about 300 million dollars. Little net change in excess reserves occurred in the final week of the month, as a seasonal demand for currency, and further reductions in float and in Federal Reserve security holdings were largely offset by Treasury disbursements and by member bank borrowing from the Reserve Banks. On May 29 borrowings were greater than excess reserves for the first time since May 1933.

The outflow of gold, a factor that has absorbed substantial amounts of reserves since September 1949, was greatly diminished in May for the second successive month. During 1950 as a whole, the decline in the country's monetary gold stock came to over 1.7 billion dollars, and in the first three months of 1951 the rate of loss to foreign governments and central banks accelerated, with the actual outflow reaching almost 950 million dollars (based on weekly statement data). The marked

Excess Reserves and Member Bank Borrowing
(Weekly, Dec. 28, 1949-May 23, 1951*)



* Wednesday dates.

drop in the flow of gold from this country in the past two months, to amounts averaging 50 million dollars a month, may well represent the beginning of another fundamental change in international financial developments affecting the United States balance of payments.

EXPORT AND IMPORT PRICES OF VARIOUS COUNTRIES SINCE 1949

Since 1949 the price structures of most major countries have been subject to two powerful sets of influences. First, in September of that year, the currencies of some 30 countries were sharply devalued; and second, the outbreak of the Korean war in June 1950 released anew the pressure of armament demand and anticipatory stockpiling upon the prices of raw materials. The implications of these developments for the domestic economy of this country, and the economies of some of our principal allies, will be discussed from time to time in issues of this *Review*; the present article is confined to the changes that have occurred in the export and import prices of a broader group of countries. The outstanding characteristic of these changes has been their diversity; the experience of individual countries has not uniformly reflected the simple patterns of change often associated, in detached theoretical analysis, with the influence of devaluation or of accelerating wartime demand.

It is frequently convenient, in comparative studies of changes in the export and import prices of various countries, to use a single measure known as "the terms of trade". This index, which is merely a statistical simplification, is computed by dividing the index number of the export prices for an individual country by the index number of the prices paid for imported goods by that country. When export prices rise relative to import prices, the movement in the terms of trade is said to be favorable, since a larger physical volume of imports can then be obtained in exchange for a given volume of exports.

Conversely, when the prices of imports rise relative to the prices obtained for exports, the development in the terms of trade is considered unfavorable. As an introduction to a survey of recent price movements, a brief description will be given of some of the major factors influencing changes in the terms of trade. The actual record is then examined in the light of this introductory analysis.

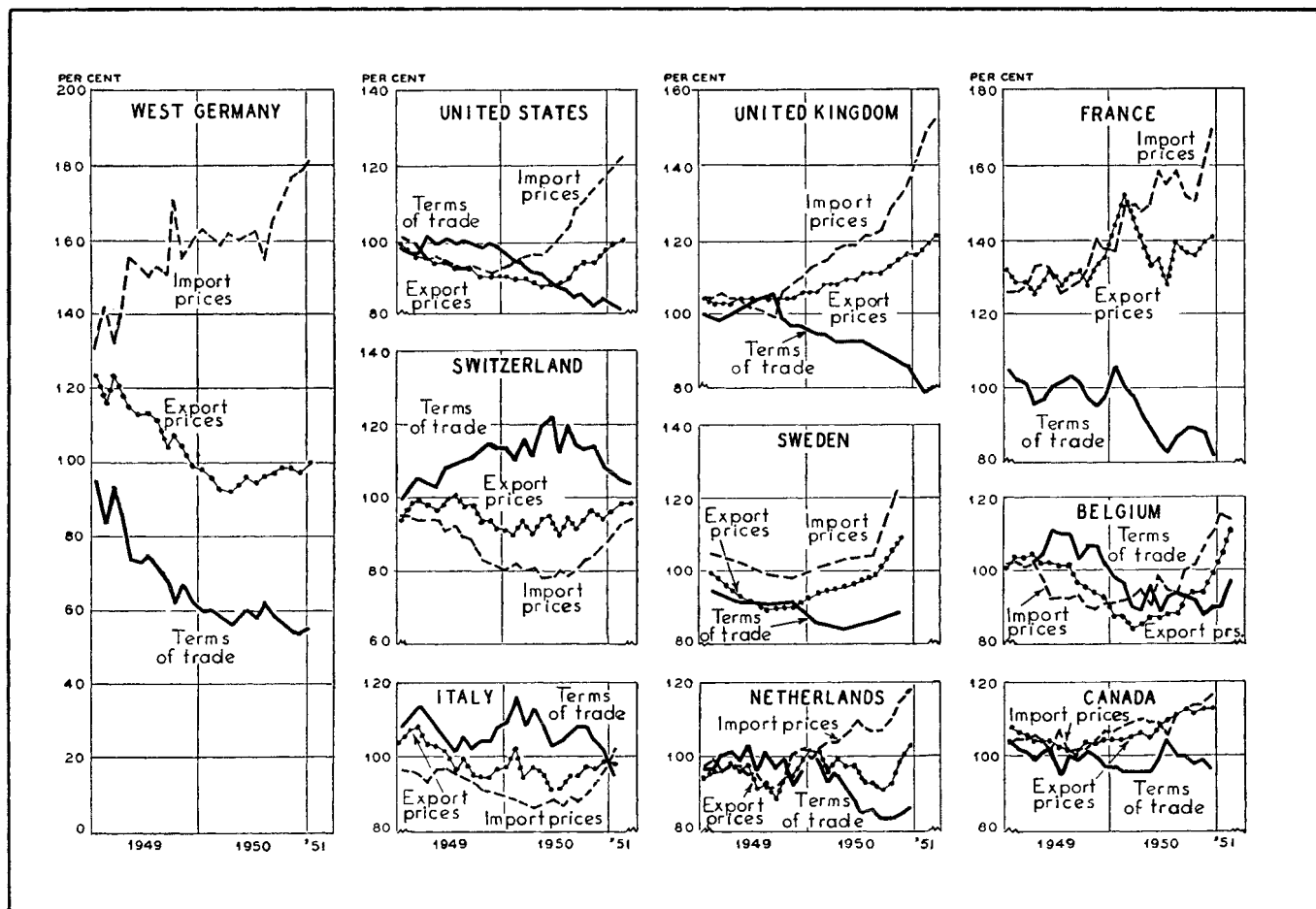
FACTORS INFLUENCING THE TERMS OF TRADE

Since the terms of trade is a ratio of index numbers, its movements depend, not only upon the trend of prices of the particular goods which the country in question exports and imports, but also upon the relative importance of the individual goods in the export and import totals (and the list of such goods changes over time). The prices of a country's export and import goods are influenced by a wide variety of factors, including the structure of world demand and supply (itself subject to a host of influences), the relative importance of the country in the world economy as a supplier and purchaser of the goods in question, movements in exchange rates, the type of national monetary and fiscal policies pursued, the volume and direction of international capital movements, and the existence of bulk-purchase contracts or international agreements covering the prices paid for individual commodities.

Since the majority of countries in the world can be loosely grouped into two broad categories of "industrialized" and "primary-producing" countries—the former being predominantly

Chart I

Import Prices, Export Prices, and Terms of Trade* of Selected "Industrialized" Countries



* Terms of trade = $\frac{\text{export prices}}{\text{import prices}}$; 1948 = 100.

Source: Statistical Office of the United Nations, *Monthly Bulletin of Statistics*; International Monetary Fund, *International Financial Statistics*.

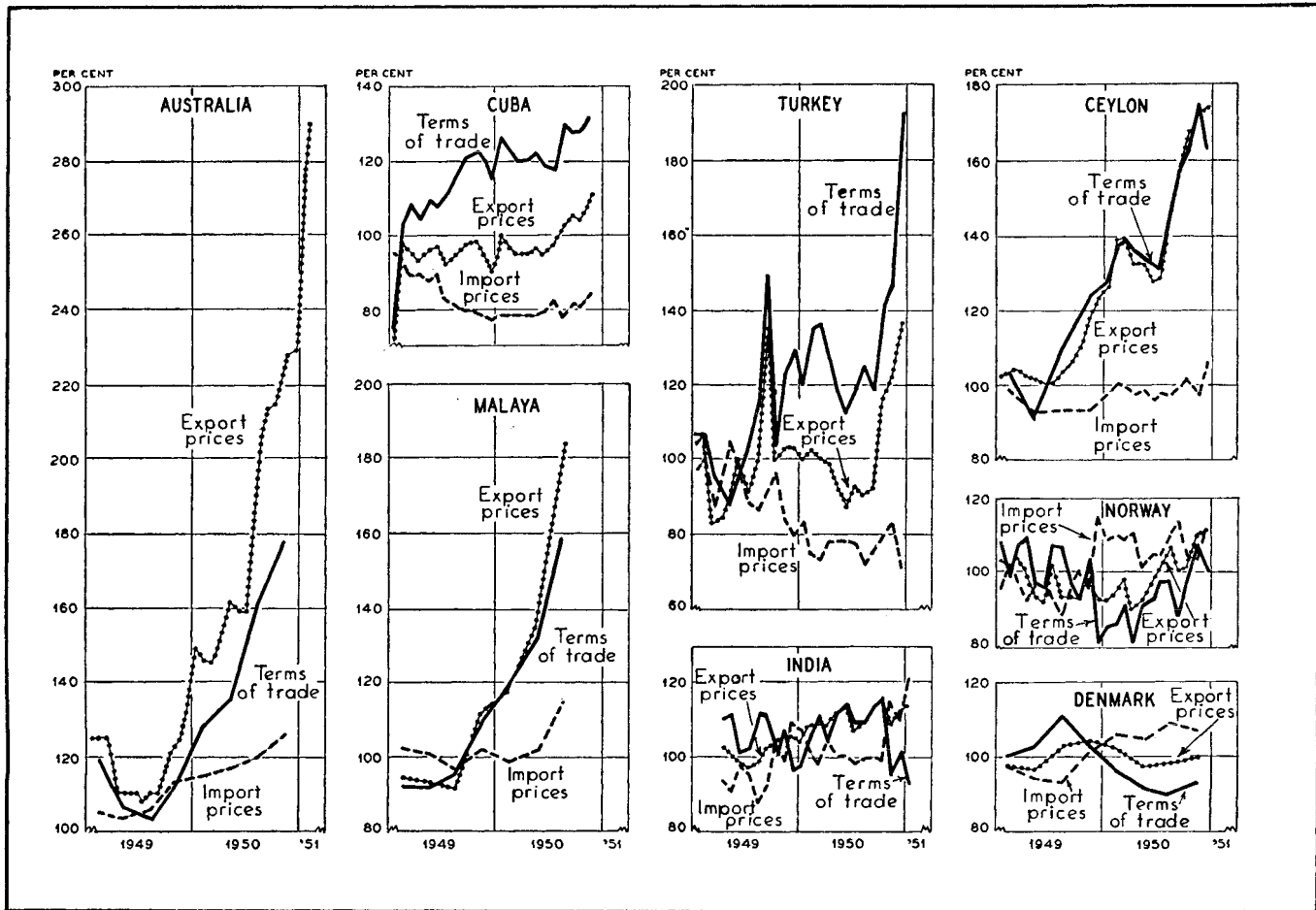
exporters of manufactured goods and importers of primary products, and the latter the reverse—it is evident that a major factor influencing the terms of trade in either group is the movement in the relation between the prices of manufactured goods and of primary products on world markets. When primary-product prices tend to rise relative to the prices of manufactures, for example, the terms of trade tend to improve in "primary-producing" countries and to deteriorate in "industrialized" countries. But the existence of wide variations in the relative price movements of individual types or classes of primary products and manufactures might well, depending on the particular products exported and imported by the country in question, cause its terms of trade to run counter to the pattern expected of its group as a whole. The export and import trade of some countries, however, is "mixed" to such a degree that they do not fall clearly into either of the broad categories of "industrialized" or "primary-producing".

When a country depreciates its currency, its export and import prices tend, in the absence of offsetting factors, to fall in terms of foreign currencies that have not depreciated (or have

depreciated to a lesser degree), and to rise in terms of its own currency. It is also the most common result of a depreciation that the import prices of the depreciating country will rise relative to its export prices, that is, its terms of trade will deteriorate, regardless of whether import and export prices are expressed in terms of the domestic currency or of foreign (non-depreciated) currencies. On the opposite side, there will usually tend to be an improvement in the terms of trade of other countries, since their currencies will enjoy a relative appreciation on the foreign exchange market. Yet a depreciating country usually expects that, despite the resulting deterioration in its terms of trade, its balance of payments will improve because of more than compensating changes in the volume of exports and imports induced by the changes in export and import prices.

In an attempt to examine the effects on terms of trade of (a) the currency readjustments of September 1949 and (b) the sharp rise in primary-product prices since June 1950, the recent movements of the export prices, import prices, and terms of trade of a number of countries are plotted in the two

Chart II
 Import Prices, Export Prices, and Terms of Trade* of Selected "Primary-Producing" Countries



* Terms of trade = $\frac{\text{export prices}}{\text{import prices}}$; 1948 = 100.

Source: Same as for Chart I.

accompanying charts. These charts, respectively, cover selected "industrialized" and "primary-producing" countries in keeping with the loose distinction drawn above.¹ As already noted, the indexes of the terms of trade of the individual countries are derived by dividing their export price indexes by their import price indexes; an improvement in the terms of trade is, therefore, shown on the charts by a rising line, and a deterioration by a falling line. Both the export and the import price indexes are, in reality, indexes of "unit value" obtained by dividing the total reported value of each item of trade by the reported number of units traded, and then weighting the resulting individual unit values according to their share in this total trade, in order to compute a composite index for either export or import prices.

THE IMPACT OF DEVALUATION

It will be observed from the charts that in the first nine

¹ There are, of course, a number of borderline cases in these charts. The structure of the export and import trade of Canada and of Sweden, for example, makes it difficult to determine precisely into which of the two categories these countries belong.

months of 1949, immediately preceding the devaluations, the general trend of both the export prices and import prices of most countries was moderately downward. This trend was primarily a reflection of the moderate downturn in world economic conditions associated with the relatively mild recession in the United States that had commenced at the end of 1948. Since, during this period, the prices of raw materials and foodstuffs declined, in general, more sharply than those of manufactured goods, the "normal" expectation would be for the terms of trade of "industrialized" countries to improve and of "primary-producing" countries to deteriorate. As far as the "industrialized" countries were concerned, this presumption tended, in fact, to be borne out for the United States, the United Kingdom, Belgium, Switzerland, and the Netherlands; but in the case of West Germany and Italy the terms of trade actually deteriorated, and in the case of Sweden, France, and Canada the evidence is inconclusive.² In the "primary-producing"

² The terms of trade of Europe as a whole improved by about 8 per cent during the first three quarters of 1949. See *Economic Survey of Europe in 1949*, Economic Commission for Europe (Geneva, 1950), p. 148.

countries shown in Chart II, moreover, the terms of trade tended more often to improve than to deteriorate. Probably no great significance should be attached to any of these results, however, because the movements in export prices and import prices during this period were not substantial.

The exchange devaluations of September 1949 were so extensive (involving the currencies of some 30 countries) and of such considerable dimensions (the majority of the currencies being devalued in terms of gold and dollars by about 30 per cent) that a widespread impact on export prices, import prices, and the terms of trade was inevitable. It is exceedingly difficult, however, to isolate the price effects of the devaluations in view of the existence of other factors simultaneously at work, notably the renewed general upturn in world economic conditions which occurred at about the same time. A further complication lies in the fact that, since the degrees of devaluation were not the same for all the devaluing countries, the individual currencies concerned depreciated against some currencies, remained unchanged against others, and in some instances, appreciated against still others.

In attempting to trace the price effects of the devaluations, attention can safely be focused only on the period from September 1949 to June 1950. The rise in world raw material prices since that time, under the stimulus of the inflationary impulse imparted by the Korean war, has been so sharp as to have undoubtedly overshadowed any further price effects that the devaluations might have had.

It was noted earlier that, in the absence of offsetting factors, a devaluation tends most commonly to raise the import prices of the devaluing country more sharply than its export prices—both expressed in that country's currency—and thereby to worsen its terms of trade. Conversely, in countries which do not devalue, and the currencies of which consequently appreciate, import prices should tend to fall more than export prices, and the terms of trade to improve. An examination of Charts I and II, however, reveals some significant departures from these patterns in the period from September 1949 to June 1950.

In the United Kingdom, Sweden, and the Netherlands—all of which devalued their currencies by approximately 30.5 per cent—the "normal" expectation was fulfilled in that import prices rose by more than export prices and the terms of trade deteriorated. British import prices would have risen even more were it not for the fact that the United Kingdom has long-term bulk purchase contracts covering a substantial part of its imports of foodstuffs and raw materials. On the other hand, in the cases of Belgium, West Germany, France, and Italy, which devalued their currencies by lesser amounts, the picture is less clear-cut. In Belgium and West Germany import prices rose after the exchange readjustments and the terms of trade deteriorated, in keeping with expectations, but export prices actually continued to fall until the spring of 1950, in part because of declining costs associated with productivity increases. In France import and export prices rose

in the months immediately following devaluation, but there was no clear-cut trend in the terms of trade; from January to June 1950, however, the terms of trade deteriorated sharply under the influence of a fall in export prices and further rises in import prices. In all these cases, the increases in import prices were a reflection, not only of the devaluations themselves, but also of a rising tendency in world prices of raw materials—of which Western Europe is an important importer—associated with the upturn in general business conditions. In Italy the terms of trade actually improved in the five months following the September devaluation, perhaps in part because the lira, which depreciated against the dollar by only 8 per cent, appreciated against the currencies of other main trading partners.

The terms of trade of the United States, far from improving as a result of the appreciation of the dollar in terms of many foreign currencies, actually deteriorated. For, while export prices continued to fall until May 1950, import prices actually rose steadily after November 1949. The latter movement was the result of the recovery in United States business activity and the consequent increase in demand for imported goods which, because the United States represents so large a proportion of total world demand, more than offset the potentially depressing effect of the foreign devaluations on our import prices. In Switzerland, another country which did not devalue its currency, import and export prices continued to fall following the devaluations and the terms of trade tended to improve—all in accordance with expectations—but the movements were somewhat irregular.

The behavior of the export prices, import prices, and terms of trade of "primary-producing" countries, from September 1949 to June 1950, may be more briefly summarized. All of the countries represented in Chart II, except Cuba and Turkey which did not adjust their exchange rates, devalued their currencies by about 30.5 per cent. Instead of undergoing a deterioration in their terms of trade, however, the majority of the devaluing countries experienced a greater rise in their export prices than in their import prices, and a consequent improvement in their terms of trade. This pattern, which shows up most clearly in the case of Australia, Ceylon, and Malaya, stemmed fundamentally from the general increase in the world demand for primary products, which, together with the effect of the devaluations, raised the export prices of "primary-producing" countries to a degree which more than offset the rise in import prices in these countries associated with the devaluations.³ In the case of Denmark and Norway, on the other hand, the terms of trade did deteriorate, since export prices failed to rise correspondingly with import prices;⁴ and the Cuban and Turkish cases are inconclusive.

³ The softening in the prices of a number of basic commodities in the late spring of 1950, however, is evident in the export price series of most of these countries.

⁴ Danish export prices even declined somewhat in view of reductions in the sterling prices of their chief agricultural exports under the terms of long-term sales contracts with Britain.

In general, however, the terms of trade of "primary-producing" countries, including those not covered by Chart II, improved during this period, whether they devalued their currencies or not.

PRICE CHANGES FOLLOWING THE OUTBREAK OF WAR IN KOREA

The spectacular rise since June 1950 in world prices of primary products, especially raw materials, in absolute terms and relative to the prices of manufactured goods, has resulted in further marked changes in export prices, import prices, and the terms of trade of a sort that might logically be expected, and has, in general, strengthened the trends apparent in earlier months. With only a few minor exceptions, as is indicated in Chart I, the terms of trade of "industrialized" countries have moved sharply in an unfavorable direction, with import prices rising faster than export prices. The Swedish terms of trade have, however, tended to improve in view of an unusually strong demand for Sweden's chief exports, notably forestry products. With regard to "primary-producing" countries, as is evident from Chart II, there has for the most part been a further improvement in the terms of trade since June 1950 under the influence of sharp rises in export prices and of lagging increases in import prices. This improvement has, in general, been much more striking for those countries which chiefly export raw materials rather than foodstuffs, in view of the much sharper price rises in the former commodities.⁵ In the case of India, the terms of trade have actually deteriorated.

The marked unfavorable development in the terms of trade of the majority of Western European countries has, especially since June 1950, had adverse repercussions which, even in the absence of further deterioration, threaten to be intensified in the reasonably near future. By adding substantially to the cost of imports in terms of exports, the worsening of the terms of trade has put a growing squeeze on the balances of payments and the domestic resources of these countries. Some measure of its impact is provided by the fact that in 1950 the value of British imports was about 400 million pounds higher than in 1949 (an increase of some 20 per cent) solely because of the increase in import prices, since the volume of imports was virtually the same in both years. Although the value of British exports rose by the same amount, leaving the balance of trade unchanged, only about 115 million pounds of that rise was attributable to higher export prices. As a result of the deterioration in its terms of trade, therefore, it was necessary for Britain to export 285 million pounds more goods in 1950 in order to obtain the same volume of imports as in 1949. This involved the loss of an equivalent amount of resources that would have otherwise been available for domestic use. In West Germany, the worsening of the terms of trade similarly involved a net burden on the German

economy of 725 million deutsche marks between June 1950 and February 1951, an amount equivalent to 60 per cent of the total value of its imports in the latter month. The experience of most other Western European countries has in this respect been similar; and, in those cases where the volume of exports could not be appropriately expanded, trade balances have deteriorated.

IMPLICATIONS FOR THE FUTURE

The worsened terms of trade of Western Europe will pose progressively serious problems for that area now that its rearmament program is beginning to get under way. For that program will involve not only increased import requirements of raw materials and essential foodstuffs, but also increased demands upon strained domestic resources which will make it difficult to maintain the volume of exports, let alone expand it sufficiently to compensate for the deterioration in the terms of trade and for the larger import needs. By the same token, domestic inflationary pressures will be accentuated by the worsening of the terms of trade—to say nothing of the direct inflationary impact upon domestic cost and price structures exerted by the rise in import prices itself.

In 1951 Europe as a whole will, according to recent estimates, have to pay about 3 billion dollars more to obtain even the same volume of imports it obtained in 1950, given the prices existing at the beginning of 1951; and some further rises in Europe's import prices and import volumes seem in the offing. Gradually rising export prices (resulting from the higher import prices and other inflationary forces) will undoubtedly cover part of the higher prospective import bill, but, barring some unexpectedly sharp decline in raw material prices, a substantial expansion in export volume will be needed if Europe's trade deficit with the rest of the world is not to

BANKING REFORM IN SOUTH KOREA

A limited number of copies of a monograph entitled *Banking Reform in South Korea* are available free of charge from the Balance of Payments Division, Federal Reserve Bank of New York, New York 45, N. Y. This report is the work of two members of this bank's staff, who spent six months in Korea at the request of the South Korean Minister of Finance at the end of 1949 and early in 1950. It contains their recommendations with respect to reorganization of the central bank and general reform of the banking system; analyses which they prepared of financial and economic developments in South Korea from 1945 to 1950; and the texts of the banking legislation enacted by the South Korean National Assembly in April 1950. Although the invasion of South Korea has completely changed the economic and political conditions and problems of the Republic of Korea, the study may be of interest to students of central banking and of financial and banking history.

⁵ Cuba, for example, whose predominant export is sugar, has experienced only a very moderate improvement in terms of trade.

rise significantly in the near future. Since such expansion seems unlikely, a deterioration in Europe's trade position (even apart from military-end goods) appears probable. To the extent that national and international measures of allocation and control stem further rises in world raw material prices, the magnitude of the problem would, of course, be reduced.

As far as "primary-producing" countries are concerned, the major effect of the sharp improvement in their terms of trade during the past 18 months has been markedly to improve their balances of payments and to add to their foreign exchange and gold holdings. This development has, in turn, imparted strong inflationary pressures to their domestic economies by adding to the current flow of incomes and to the money supply. A

number of these countries have recently imposed or increased duties on specific export commodities, relaxed import controls, or undertaken other anti-inflationary measures. The improvement in the terms of trade has also provided "primary-producing" countries with the opportunity of obtaining a larger volume of imports in exchange for their exports and of thus acquiring a net addition to their resources for purposes of economic development. But it is much more doubtful whether these countries will, in fact, at a time of growing pressure on supplies in "industrialized" countries, be able in the near future to increase the volume of their imports to any appreciable degree, and thereby to reap the full potential benefits of their improved terms-of-trade position.

FINANCING SECURITY BROKERS AND DEALERS

Last month the interest charge on most bank loans secured by stock exchange collateral was increased to 2½ per cent in New York City, bringing this rate as high as banking rates on prime commercial loans for the first time in many years. This development serves as a reminder of the fundamental changes that have occurred in the call loan market—in the fluctuations of call loan rates, the volume of activity, the mechanics of operation, and the degree of interdependence between this market, the money market, and bank reserves—over the past two decades.

In 1929, before the stock market break, security loan rates in New York varied from day to day over a range from about 5 to 15 per cent, generally remaining well above the rates for prime commercial paper. The aggregate volume of security loans extended by banks and others was several times the volume today. The market then was impersonal, with transactions occurring largely through the money desk on the New York Stock Exchange; that desk was discontinued in 1946, after more than a decade of negligible activity at an unchanging interest rate of 1 per cent, and security loans are now largely made by banks through direct negotiation with the borrowers. Loans "for the account of others" have been legally prohibited since mid-1933. The proportion of their earning assets which the weekly reporting banks in New York City now lodge in security loans is about one sixth of the 1929 ratio; for all other banks, the present proportion is only about one tenth that of 1929. To a degree, security loans have tended to become comparable to customer loans and so are a part of the normal lending business, rather than representing primarily a residual employment for excess funds, or the first means of obtaining funds from the money market in the event of a drain on bank reserves.

Bank reserve adjustments have not for some time centered on the call loan market, and for nearly a decade short-term Treasury securities have been relied upon as the principal (negotiable) money market instrument. As a result, the liquidity of the money market does not now depend upon call loans that reflect activity and prices in the stock markets; nor are the stock markets heavily influenced by short-run changes

in the availability of money market funds. Thus, an institutional arrangement that was at one time an important source of cyclical instability in the financial sector of the economy has now largely disappeared.

This article will describe, in part, the kind of security loan market that has emerged, following these fundamental changes. It discusses the present characteristics of one of the most important segments of that market, the loans to brokers and dealers. The review will include a brief summary of the purposes for which brokers and dealers borrow, the sources of funds for these loans, the principal types of loans made, the legal margin requirements, and the customary practices of the banks in relating their own margin requirements and interest charges to the nature of the securities offered as collateral.

WHY BROKERS AND DEALERS BORROW

Brokers and dealers in securities require bank credit in order to finance: (1) their customers' purchases of securities, (2) their own "positions" or inventories of securities held either in short-term trading accounts or in longer-term investment accounts, (3) their purchasing and carrying of new security issues pending sale to ultimate investors, and (4) the delivery or clearance of securities traded.

Available data are not sufficiently detailed to show the actual volume of bank funds used in satisfying the various purposes for which brokers and dealers borrow. It is possible, however, to indicate their order of magnitude within the two broad classes into which broker and dealer loans are subdivided—those for "purchasing or carrying other securities" and those for "purchasing or carrying Government securities". On May 16, loans on other securities at the weekly reporting member banks were about 1.1 billion dollars; those on Government securities were roughly 275 million dollars. The total of 1.4 billion dollars included practically all loans made to brokers and dealers by banks in the United States; and the reporting banks in New York City accounted for more than three quarters of this total. Although the reporting banks themselves do not submit data indicating the amount of their

loans used for each of the four purposes mentioned above, rough approximations can be estimated from data released by the New York Stock Exchange and other sources. Loans on "other securities" are largely of the first type (broker borrowing to finance customer purchases—mainly of stocks), although at times perhaps as much as one fourth of the total might be accounted for by either the second or the third purpose (that is, financing broker or dealer "positions", or their holding of new securities pending sale to ultimate investors). The fourth purpose relates largely to over-the-counter market transactions, which may have to be financed briefly during the process of transferring ownership; but since the greater part of these loans are made and repaid within the same day they are not shown in bank data on outstanding loans (which are reported as of the close of business on the reporting date). As far as the broker and dealer loans on Government securities are concerned, these are predominantly for financing "positions", although a small portion often represents overnight loans arranged to finance the "carry" while a transfer of ownership is being effected.

The aggregate volume of loans to brokers and dealers has fluctuated between two thirds of a billion and two billion dollars over the past four years. The variation is influenced by such factors as the current volume of trading in securities, the amount and rate of sale of market offerings of securities by business and governmental bodies, changes in security prices and in interest rates, and variations in the readiness of investors (including dealers) to take speculative positions.

During the war and early postwar period, dealer loans on Government securities constituted the largest single category of loans to brokers and dealers. Toward the end of 1945, for example, the loans on Governments amounted to close to 2 billion dollars, more than twice the volume of borrowings on other collateral at that time. There has been a sharp reduction in dealer loans on Governments since 1947. And, as already noted, on May 16 of this year loans to brokers and dealers for "purchasing or carrying Government securities" at all weekly reporting member banks amounted to less than one fourth of the loans on other securities. In aggregate amount, broker borrowings on listed stocks are now the largest outlet for bank loans to security brokers and dealers, although they have not changed materially in volume over the past several years. Dealer borrowing on Government securities now ranks second in volume, and loans to finance dealer positions in other unlisted bonds and stocks appear to rank third. A large segment of this third type probably represents funds borrowed to carry dealer positions in State and local government issues.

New security financing plays at times an important part in the fluctuations in outstanding security loans. As a rule, new publicly offered security issues will have been largely sold by the underwriters before payment is due to the issuing corporation. Loans to carry the remainder, pending sale to investors, are usually outstanding no more than one week. But a turn-

about in security prices, creating difficulties in the sale of new issues and congestion in the market, can become an important factor leading temporarily at least to an increase in security loans. Some new bond issues floated during past periods of market weakness have been carried by the underwriters on a call loan basis for several years. Treasury refunding operations have often been an important influence on the volume of dealer loans on Government securities. At such times there is ordinarily an increase in the volume of trading in Government securities, as those investors whose needs are not exactly met by the newly offered security attempt their own refunding through sales of the maturing issue in the market. In the course of facilitating this redistribution within the market, dealers tend to increase their own positions. It is, to a large extent, only after the new securities are actually issued that sales bring about a reduction in dealer positions and dealer loans. Dealer positions may also be increased by the shifting of securities within the market that precedes Treasury new money offerings.

SOURCES OF FUNDS

Security loans are mainly an outlet for the funds of banks in the leading financial centers. The member bank call report for December 30, 1950 showed that loans to brokers and dealers by central reserve city banks in New York and Chicago were about 13 per cent of the total loans of these institutions and 86 per cent of all member bank loans to brokers and dealers. The loans of the New York City banks, furthermore, were 13 times those of the Chicago banks. Within New York City only banks located in the financial district in lower Manhattan make loans to brokers and dealers on a large scale. Other banks apparently have neither the experience nor the large volume of demand necessary to make this kind of loan profitably at the comparatively low interest rates prevailing over the last two decades.

Brokerage firms which are members of an organized stock exchange have a second important source of funds, the "free" cash credit balances of their customers. Member firms may utilize such balances to finance the margin purchases of other customers. Thus, on December 30, 1950, New York Stock Exchange member firms reported that while customer and firm accounts had debit balances of about 1.4 billion and 400 million dollars, respectively, outside borrowing amounted to only 745 million dollars. The difference of more than one billion dollars was largely supplied by the free credit balances in the accounts of other customers.

TYPES OF SECURITY LOANS

Security loans may be divided into two types, those which finance holding and those which are made for a few hours to finance a change in ownership. The former may be either demand (call) or time loans; the latter are either day or overnight loans. The call and time loan agreements between brokers or dealers and the banks are similar in that under

either form the borrower agrees to keep the loan properly margined (that is, a specified proportion of his own funds invested in the securities) and to permit securities pledged against the loan to be sold by the lender in satisfaction of the debt in the event of default or of failure to maintain adequate margin. The time loan takes the form of a note in a specific amount with a specified maturity date, and may be renewed at the current renewal rate of interest. The call loan, on the other hand, takes the form of a general agreement, in which the amount of the loan is not specified. Under this agreement successive loans and repayments are made, and any indebtedness may be terminated at short notice either on demand of the lender or repayment by the borrower. In both cases, substitution of collateral is freely permitted with due regard for the quality of the new collateral and the margin required. Most security loans are made on a call basis, and in current practice such loans are rarely called. Repayment is normally at the initiative of the borrower.

The maximum amount of call (and time) loans outstanding to any one borrower is governed by the quality of the collateral, the credit standing of the broker or dealer, and the loan limit of the bank. The New York Stock Exchange stipulates that the aggregate indebtedness of its members may not exceed 15 times the net capital of each firm. The loan officer of an individual bank determines the credit limit for each broker or dealer on the basis of the borrower's credit standing and the quality of the pledged securities. The aggregate amount of loans to any one broker or dealer may not, of course, exceed 10 per cent of the capital and surplus of a national bank or a New York State member bank, except that for Government security loans the maximum is 25 per cent.

The practice in this country of making full cash payment daily for security purchases (in contrast with the fortnightly settlements in Great Britain, for example) has necessitated the creation of special types of temporary credit accommodation for dealers in securities. These are known as the day loan and the overnight loan, which are used primarily by those dealing in Government securities and various over-the-counter issues (most payments for stock exchange transactions are offset through clearing arrangements). Day loans, payable on the same day they are made, enable dealers (1) to pay for securities they have contracted to purchase and receive, and (2) to pay off a loan against which securities have been pledged in order to release those securities for delivery to a buyer against payment. Overnight loans provide dealers with funds to pay off day loans, and thus enable them to hold overnight securities they have not been able to deliver during the day.

Both the day and the overnight loans are evidenced by a note for a specific sum of money. The overnight loan is fully secured by securities pledged against the loan. The day loan is safeguarded by a lien or chattel mortgage on the securities in the process of receipt or delivery, and a list of the securities involved may be attached as part of the day loan note, but the lender does not have possession of the securities. Day loans

require no margin and the rate of interest in New York has remained fixed at one per cent since day loans were first made in 1929. Overnight loans are subject to the same maximum loan values and interest rates as other security loans.

REGULATIONS T AND U

Under powers delegated by the Securities Exchange Act of 1934, the Board of Governors of the Federal Reserve System has issued Regulations T and U which, in general, place limits on borrowing to purchase or carry "listed" securities (i. e., securities listed on national security exchanges registered with the Securities and Exchange Commission). Regulation T applies to extensions of credit which brokers and dealers (including members of national security exchanges) make to their customers; Regulation U applies to loans made by banks on any stock for the purpose of purchasing or carrying listed stocks. The Board has the power to vary the borrowing limits, which are called "maximum loan values", with changing conditions. At the present time, the effect of the Regulations is to require customers (including brokers when operating for their own account) to use their own funds, that is to provide "margin", for 75 per cent of the purchase price of a security. Federal Government, State, and municipal bonds are exempt from both Regulations. Other bonds are exempt from Regulation U (loans made by banks) but not Regulation T (loans made by brokers). Regulation T, in addition, prohibits brokers and dealers from extending credit for the purpose of purchasing or carrying those unlisted securities which are not exempt from regulation.

In extending credit to firms which are members of a stock exchange, the New York City banks require such firms to sign a statement declaring that they are subject to Regulation T. In the case of loans on listed issues, borrowing firms are also required to segregate their customers' securities from their own holdings. Among other purposes, this segregation permits the banks to lend to brokers somewhat more freely against customers' securities, which have already been "margined" by the customers under Regulation T, than on securities owned by the broker himself, since the banks must treat these in conformity with Regulation U.

The legal prescription of maximum loan values, generally referred to as the regulation of margin requirements, has been effective in limiting the volume of bank credit used to finance speculative transactions in listed stocks. The security loan, and more particularly the call loan, has in the process been made a relatively safe use of funds, much less vulnerable than formerly to changes in security prices.

INFLUENCE OF COLLATERAL ON LOAN VALUES AND INTEREST RATES

As shown in the accompanying table, the maximum loan value which banks themselves permit for security loans, and, to a lesser extent, the interest rates charged on such loans, vary with the type of security offered as collateral. The

Terms of Call Loans to Brokers and Dealers on Securities
New York City Banks (as of May 16, 1951)*

Type of issue	Loan values (In per cent of market price)	Interest rates (In per cent)
<i>Outstanding</i>		
<i>Stocks</i>		
<i>Listed</i>		
Customer accounts.....	66 $\frac{2}{3}$	2 $\frac{1}{2}$
Firm accounts.....	25	2-2 $\frac{1}{2}$
Unlisted.....	50-60	2-2 $\frac{1}{2}$
<i>Bonds†</i>		
Corporate.....	75-95	2-2 $\frac{1}{2}$
Municipal.....	80-98	2-2 $\frac{1}{2}$
Government.....		
Maturing in 1 year or less....	95-100	2-2 $\frac{1}{4}$
Maturing in over 1 year....	95-98	2-2 $\frac{1}{4}$
<i>New issues</i>		
<i>Stocks</i>		
Listed.....	90-95	2-2 $\frac{1}{2}$
Unlisted.....	90-95	2-2 $\frac{1}{2}$
<i>Bonds</i>		
Corporate.....	90-95	2-2 $\frac{1}{2}$
Municipal.....	90-95	2-2 $\frac{1}{2}$

* Data are a composite of lowest and highest loan values and interest rates found in a survey of four leading New York City banks.

† Includes short-term securities.

loan values which the banks specify for brokers' loans on listed stocks generally amount to two thirds of the market value of such securities whenever the purpose of the loan is to finance customer dealings already subject to Regulation T. Banks may permit these loan values to rise to, but not often over, 75 per cent. To carry listed stocks (apart from underwriting operations) in their own portfolios on borrowed money, however, stock exchange firms and others can presently borrow no more than 25 per cent of the market value, as required by Regulation U. The loan values which the banks specify on loans secured by unlisted stocks are in the neighborhood of 50 per cent, and progressively higher loan values are allowed on loans secured by corporate bonds, the securities of State and local governments, and obligations of the Federal Government.

Loans on new corporate and municipal security issues, held in underwriting syndicates pending distribution to the public, are permitted to represent a higher proportion of market value than would normally be allowed for loans on outstanding issues.

Rates charged brokers and dealers on security loans also vary somewhat depending on the quality of the collateral and the character of the business of the broker or dealer. Interest rates charged by the New York City banks on loans secured by stock exchange collateral are usually $\frac{1}{4}$ to $\frac{1}{2}$ of one per cent higher than those charged when the collateral consists of Government securities. As noted at the beginning of this article, the interest rate on call loans secured by stocks was raised to 2 $\frac{1}{2}$ per cent on May 15. Most New York City banks also charge the stock exchange call rate on broker and dealer loans secured by corporate and municipal bonds and unlisted stocks. Only those dealers who actively maintain markets in Government securities are granted the lower rate on Government security loans. Call rates on Governments fluctuate daily with money market conditions. Currently, the rate ranges from a minimum of 2 per cent to a maximum of 2 $\frac{1}{4}$ per cent.

SECURITY LOANS NO LONGER A MARKET INSTRUMENT

The present characteristics of the security loan market are markedly different from those of the late twenties. As presently organized, on an over-the-counter basis, the market for loans to brokers and dealers accounts for a relatively small proportion of the earning assets of the commercial banking system. Despite the fact that most of these loans are made in demand (call) form, the possibility no longer exists for a repetition of the type of "call money panic" that at times proved so disastrous in the past. The call loan has ceased to be an important money market instrument.

DEPARTMENT STORE TRADE

Preliminary information indicates that during May department store sales in the Second District increased less than seasonally. This bank's index of Second District department store sales, adjusted for seasonal variation, was estimated to have declined to 243—9 percentage points below the April 1951 level.

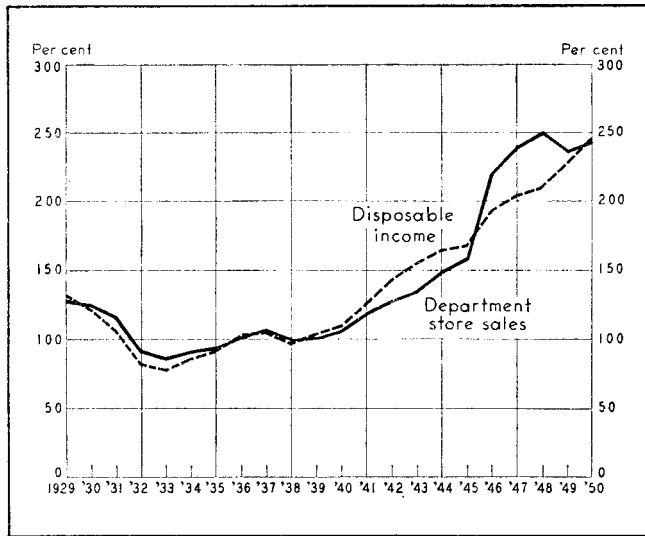
Despite seasonable weather, sales of men's and women's apparel during May were not up to retailers' expectations. Moreover, consumer demand for major household durables was considerably below year-ago levels although extensive promotions of rugs and carpets (particularly in New York City) were reported moderately successful. Stocks held by the District's department stores at the end of April remained at the record level reached a month earlier. Most of the year-to-year increase in inventories represented accumulation of hard goods, although stocks of nondurables, notably men's and women's apparel, were substantially higher than on April 30, 1950. The dollar volume of new orders placed by the stores

during April was almost a third smaller than a year ago. Total commitments outstanding on April 30 had been reduced by almost one half since the end of February, but were still 27 per cent higher in value than at the end of April last year.

DEPARTMENT STORE SALES AND DISPOSABLE INCOME, 1929-1950

By far the most important factor affecting the general level of consumption expenditures is the quantity of expendable income left at the disposal of consumers after payment of taxes (frequently referred to as "disposable income"). This article discusses one manifestation of consumer demand—department store sales—and its relationship to disposable income in the Second Federal Reserve District. Because of the widely diversified nature of department store sales the general trends discussed are broadly applicable to most types of retail outlets. Similarly, much the same relationships probably prevail in other regions and in the country as a whole.

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



In the slightly more than two decades between 1929 and 1950 disposable income and department store sales moved together with a high degree of consistency. In 1950, the approximately 31 billion dollars of disposable income available to residents of this District represented an increase of 87 per cent above the 1929 level. Over the same period, sales of Second District department stores rose 92 per cent. As the chart shows, the movements of the two series were marked by similarity in the timing and relative magnitude of peaks and troughs. Both fell off markedly between 1929 and 1933, turning upward thereafter, and, except for a brief setback in 1938, both continued to rise steadily under the stimuli of war production and rising prices.

Between 1929 and 1941, the portion of disposable income which consumers in this District spent in department stores showed little variation, ranging from 4.8 per cent in 1932 and 1933 to 4.1 per cent of the total in 1941. The somewhat higher proportion during the depression years may, in part, reflect a tendency of consumers to spend out of savings or to reduce current savings in such periods, thus causing a smaller reduction in expenditures than in income. Although there were rather sharp deviations from the prewar relationship between sales and income during the years from 1942 through 1948, the tendency in the past two years has been toward a resumption of the prewar relationship.

The similarity in the movements of the two series during the prewar years is further confirmed by a calculation of the statistical correlation between the data for sales and income. The correlation between disposable income and total department store sales in the Second District from 1929 to 1941 was remarkably close and indicated that, for every increase (or decrease) of one million dollars in disposable income, the average gain (or loss) in department store sales amounted to approximately 35 thousand dollars.

During the war years the dollar volume of department store sales increased steadily but did not keep pace with the rise in disposable income, primarily because of the acute shortages of consumer durables. In addition, price controls, consumer credit regulations, excise taxes, and war bond purchases helped to keep the sales volume below what might have been expected on the basis of prewar relationships to income. On the other hand, the manufacture of nondurables for civilian use was not as seriously disrupted during the war years as was the output of durables (although the selection and quality of goods available was somewhat limited). As a result, sales of nondurable goods were more nearly consistent with the rise in disposable income and provided not only department stores, but also some other types of retail outlets that had not previously carried these lines, with a major share of their wartime sales revenue. The parallel movements of apparel sales and disposable income during World War II indicate that consumers generally did not buy excessive amounts of apparel and other nondurable goods, even though money was available and there were few if any hard goods to buy.

With the cessation of hostilities in 1945, restrictions on production were greatly reduced and the reconversion of durable goods industries to civilian production was soon under

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

Item	1951			1950
	April	March	February	April
Sales (average daily), unadjusted.....	232	230	218	228 _r
Sales (average daily), seasonally adjusted.....	252	230	263	237 _r
Stocks, unadjusted.....	306	306	273	238 _r
Stocks, seasonally adjusted.....	297	299	281	231 _r

_r Revised.

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

Locality	Net sales		Stocks on hand April 30, 1951
	April 1951	Jan. through April 1951	
Department stores, Second District.....	+ 2	+14	+29
New York City.....	+ 3	+14	+30
Northern New Jersey.....	+ 3	+17	+33
Newark.....	+ 3	+17	+34
Westchester County.....	- 5	+15	+16
Fairfield County.....	- 5	+14	+22
Bridgeport.....	- 4	+15	+23
Lower Hudson River Valley.....	-10	+ 8	+23
Poughkeepsie.....	- 8	+10	+25
Upper Hudson River Valley.....	+ 1	+16	+19
Albany.....	+ 6	+21	+26
Schenectady.....	- 7	+10	+18
Central New York State.....	+ 2	+15	+29
Mohawk River Valley.....	- 3	+13	-31
Utica.....	+ 0	+ 9	+34
Syracuse.....	+ 5	+16	+28
Northern New York State.....	-15	+ 8	+17
Southern New York State.....	- 2	+18	+17
Binghamton.....	- 4	+15	+12
Elmira.....	+ 3	+26	+28
Western New York State.....	0	+14	+33
Buffalo.....	+ 2	+14	+37
Niagara Falls.....	-10	+12	+31
Rochester.....	- 3	+13	+27
Apparel stores (chiefly New York City).....	- 6	+ 8	+20

way. The relaxation of price controls during the summer of 1946 also helped to stimulate the production and distribution of consumer goods. By 1947, although men's clothing was still in rather short supply, abundant quantities of most other types of merchandise were available for the first time in five years. Consumers took full advantage of the re-stocked shelves and as a result department store sales reached unprecedented heights, rising well above the prewar ratio between these sales and disposable income. By the end of 1948, the post-war buying spree had just about run its course and during 1949 the level of department store sales approached more closely the prewar relation with disposable income.

The return to what might be considered the normal relationships between department store sales and disposable income was interrupted in June 1950 by the advent of the war

in Korea. The summer buying wave in 1950, motivated by consumers' anticipations as to the effects of the Korean war and the defense program on civilian production, was of considerable intensity but of short duration. The resurgence of department store sales at the end of 1950 did, however, in combination with the summer buying wave, raise the aggregate level for the entire year slightly above that of 1949. Thus total sales both in 1949 and 1950 were somewhat greater than might have been expected from a simple statistical projection of the prewar relationship between department store sales and disposable income.¹

¹ A more detailed analysis of the relationship between department store sales and disposable income in the Second Federal Reserve District from 1929 to 1950 will be available after July 15. Requests should be sent to the Domestic Research Division, Federal Reserve Bank of New York.

MANUFACTURERS' SALES AND INVENTORIES

The manufacturers' sales and inventories statistics which appear in the table of Business Indicators are part of a group of monthly estimates, covering sales and inventories of major forms of business, prepared by the Office of Business Economics of the U. S. Department of Commerce from reports submitted by a large sample of business firms. Such estimates are made for retail and wholesale trade as well as for manufacturing, and within these three major classifications, breakdowns are available for the durable and nondurable goods industries as a whole and for individual industry groups. Manufacturers' inventories are also estimated by stage of fabrication—purchased materials, goods in process, and finished goods. The related series on manufacturers' new orders (total, and durable goods) and retail sales, which also appear in the table of Business Indicators, will be described in future articles.

The figures given for manufacturing inventories represent the book value of inventories held by corporate as well as non-corporate manufacturing firms at the end of each month. Goods in transit or in warehouses and the inventories of sales branches are included along with those physically located at the manufacturing plants. The sales figures are estimates of net sales made by all manufacturing companies during each month. The over-all sales figures are larger than the value of final products because sales totals involve duplication in so far as the end product of one manufacturer is sold to another to be used as material for further fabrication. Intracompany transfers, however, are excluded from the sales figures.

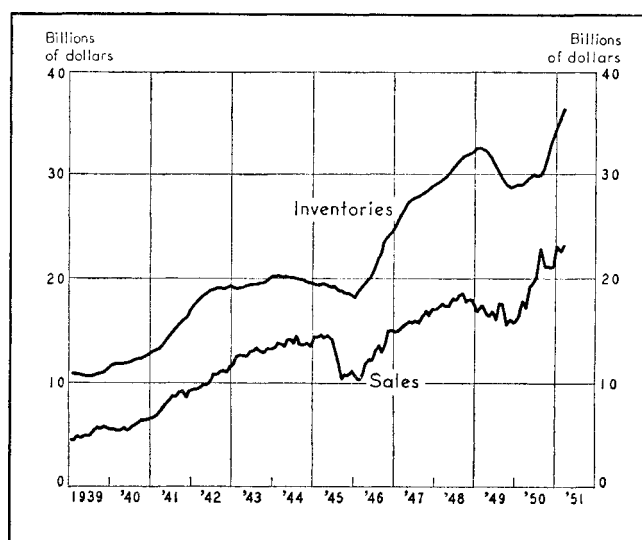
Data for both sales and inventories are available from January 1939 to date and may be obtained from the Department of Commerce on request. Current figures for the two series are published regularly in the Commerce Department's *Industry Survey* and its *Survey of Current Business*. Detailed figures in millions of dollars are published in the *Survey of Current Business* with and without adjustment for seasonal fluctuations. The table of Business Indicators shows only seasonally adjusted data, rounded to billions of dollars.

As shown in the chart, manufacturers' inventories are subject to broad, gradual movements. They are slow to adjust to changes in the level of business operations and to changes in expectations. The turning points of this series may lag behind those of the general business cycle by six months or more.

Manufacturers' sales, on the other hand, reflect short-term factors and show erratic movements even after month-to-month variations caused solely by normal seasonal influences have been eliminated.

The monthly sales and inventories estimates are derived from reports submitted by companies which account for approximately 30 per cent of the sales of all manufacturers. These statistics are revised annually to adjust them to levels indicated by a compilation of corporate tax returns made by the Bureau of Internal Revenue (BIR), supplemented by cor-

Manufacturers' Sales and Inventories
(Monthly data, adjusted for seasonal variation)



Source: U. S. Department of Commerce.

responding data for unincorporated firms obtained from individual income tax returns. These revisions correct for cumulative errors arising from any bias which might occur in the sample. However, these compilations by the Bureau of Internal Revenue require considerable time, and the final adjustment of the estimates for a given year to the level of the BIR compilations is delayed for several years. The latest "benchmark" data used in the revision made during 1950, for example, were for 1947. The annual revisions appear usually in the October issue of the *Survey of Current Business*.

The manufacturers' inventory data are not strictly comparable with the inventory statistics of the *Census of Manufactures*, chiefly because of differences in the reporting unit for which data are collected. In the *Census of Manufactures* the unit of measurement is the establishment, and each establish-

ment is classified as a manufacturing unit according to its own activity. In the inventory statistics presented here, the unit of measurement is the company, and all establishments in each firm are grouped according to the major activity of the parent company. These inventory data form part of the basis for estimates of the "change in business inventories" and the "inventory valuation adjustment" in the national income and product series of the Department of Commerce.

The values of manufacturers' sales and inventories have risen sharply since the outbreak of the Korean war to their current record levels, partly because of higher prices but also because of substantial increases in physical volume. The Department of Commerce estimates that two thirds of the increase in book value of all business inventories since last June represents price increases.

Business Indicators

Item	Unit	1951			1950	Percentage change	
		April	March	February	April	Latest month from previous month	Latest month from year earlier
UNITED STATES							
<i>Production and trade</i>							
Industrial production*	1935-39 = 100	222 _p	222	221	190	#	+ 17
Electric power output*	1935-39 = 100	325	323	322	284	+ 1	+ 14
Ton-miles of railway freight*	1935-39 = 100	217 _p	205 _p	189	191 _r	+ 6	+ 14
Manufacturers' sales*	billions of \$	22.4 _p	23.4	22.7	17.2	- 4	+ 30
Manufacturers' inventories*	billions of \$	37.7 _p	36.4	35.5	29.4	+ 4	+ 28
Manufacturers' new orders, total	billions of \$	23.8 _p	28.6	25.5	17.2	-17	+ 38
Manufacturers' new orders, durable goods	billions of \$	12.5 _p	15.5	13.2	7.9	-19	+ 58
Retail sales*	billions of \$	12.0 _p	12.3	13.1 _r	11.1	- 3	+ 8
Residential construction contracts*	1923-25 = 100	277 _p	292	311	298	- 5	- 7
Nonresidential construction contracts*	1923-25 = 100	372 _p	314	334	273	+18	+ 36
<i>Prices, wages, and employment</i>							
Basic commodity prices†	Aug. 1939 = 100	373.9	380.9	389.2	248.4	- 2	+ 51
Wholesale prices†	1923 = 100	183.5 _p	184.0	183.6	152.9	#	+ 20
Consumers' prices†**	1935-39 = 100	184.6	184.5	183.8	168.5	#	+ 10
Personal income* (annual rate)	billions of \$	-	242.5 _p	241.3	213.8	#	+ 11
Composite index of wages and salaries*	1939 = 100	-	220 _p	220	205	#	+ 7
Nonagricultural employment*	thousands	46,354 _p	46,273	46,079 _r	43,212	#	+ 7
Manufacturing employment*	thousands	16,035 _p	16,058	16,002 _r	14,302	#	+ 12
Average hours worked per week, manufacturing†	hours	40.8 _p	41.0	40.9	39.7	#	+ 3
Unemployment	thousands	1,744	2,147	2,407	3,515	-19	- 50
<i>Banking and finance</i>							
Total investments of all commercial banks	millions of \$	71,040 _p	71,320 _p	71,470	76,580	#	- 7
Total loans of all commercial banks	millions of \$	54,350 _p	54,420 _p	53,540	43,800	#	+ 24
Total demand deposits adjusted	millions of \$	89,500 _p	88,990 _p	90,620	84,300	+ 1	+ 6
Currency outside the Treasury and Federal Reserve Banks*	millions of \$	27,398	27,253	27,145	27,280	+ 1	#
Bank debits* (U. S. outside New York City)	billions of \$	85.4	87.0	84.4	67.4	- 2	+ 27
Velocity of demand deposits* (U. S. outside New York City)	1935-39 = 100	105.1	103.3	100.5	91.6	+ 2	+ 15
Consumer instalment credit outstanding†	millions of \$	12,906 _p	12,975	13,073 _r	11,322	- 1	+ 14
<i>United States Government finance (other than borrowing)</i>							
Cash income	millions of \$	2,960 _p	8,489	4,877	1,683	-65	+ 76
Cash outgo	millions of \$	4,146 _p	4,219	3,522	3,344	- 2	+ 24
National defense expenditures	millions of \$	2,386 _p	2,238	1,917	1,043	+ 7	+129
SECOND FEDERAL RESERVE DISTRICT							
Electric power output*†† (New York and New Jersey)	1935-39 = 100	227	225	228	207	+ 1	+ 10
Residential construction contracts*	1923-25 = 100	-	188	189	182	- 1	+ 12
Nonresidential construction contracts*	1923-25 = 100	-	213	229	233	- 7	- 12
Consumers' prices†** (New York City)	1935-39 = 100	180.6	180.4	180.8	165.9	#	+ 9
Nonagricultural employment*	thousands	-	7,330.0 _p	7,309.2	6,960.2	#	+ 6
Manufacturing employment*	thousands	2,660.8 _p	2,659.5	2,651.7 _r	2,433.7	#	+ 9
Bank debits* (New York City)	billions of \$	46.4	49.7	43.4	37.8	- 7	+ 23
Bank debits* (Second District excluding N. Y. C. and Albany)	billions of \$	3.7	3.8	3.8	2.9	- 2	+ 28
Velocity of demand deposits* (New York City)	1935-39 = 100	119.9	126.7	110.8	109.4 _r	- 5	+ 10

p Preliminary. *r* Revised. †† Corrected series. ** Revised series.
 * Adjusted for seasonal variation. † Seasonal variations believed to be minor; no adjustment made. # 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, May 29, 1951)

Output and incomes were generally maintained in April and May, reflecting in part a further expansion in Federal defense activities. Consumer demands for most durable goods slackened further, and total value of retail sales was only moderately above year-ago levels. Wholesale commodity prices decreased slightly in May and common stock prices showed fairly marked declines. Bank loans to business have shown little change since early April.

INDUSTRIAL PRODUCTION

Output at factories and mines in April, as measured by preliminary figures for the Board's seasonally adjusted index, was 222 per cent of the 1935-39 average, the same as March. Not much change in this level is indicated in May. The current level of industrial activity is about 15 per cent higher than a year ago.

Production of durable goods showed little change in April as output of industrial equipment increased somewhat less than in other recent months; passenger car assemblies decreased 15 per cent; and production of furniture, television sets, and most other household durable goods was reduced. Output of metals and most building materials was maintained at or above earlier advanced rates. Activity in the aircraft industry showed a further marked expansion.

Output of most nondurable goods was maintained in April. Production of chemicals expanded further reflecting mainly increased output of synthetic rubber and other industrial chemicals. Activity in the cotton textile industry decreased owing in part to a labor dispute which was terminated in early May.

Crude petroleum output expanded to new record levels in

April and early May, and production of anthracite rose substantially from the reduced March rate. Metal mining increased as iron ore production rose more than seasonally.

EMPLOYMENT

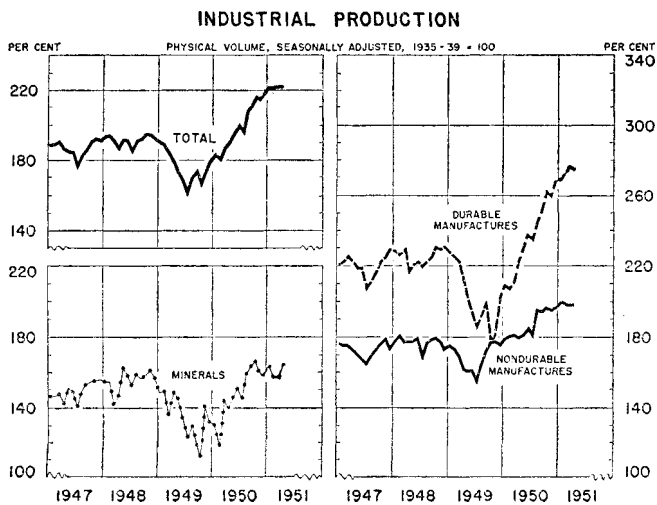
Total employment in nonagricultural establishments in April, seasonally adjusted, showed a smaller gain than in other recent months. Employment in defense and related activities continued to increase, while employment in consumer goods industries showed moderate declines. Average wage rates at manufacturing plants rose further. Unemployment declined to 1.7 million, one of the lowest levels reached in the past decade except for the war years.

CONSTRUCTION

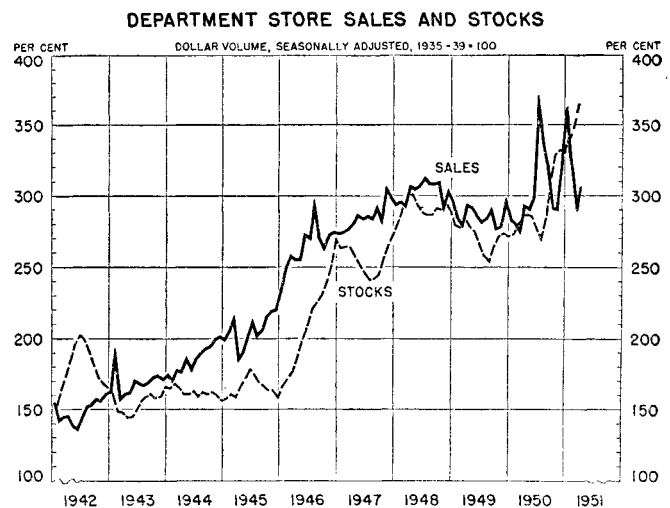
Value of construction contract awards increased seasonally in April, reflecting chiefly gains in most types of private nonresidential awards. Total awards in May are likely to increase further because of a very large contract issued by the Atomic Energy Commission. The number of housing units started in April showed a contraseasonal decline to 88,000, as compared with 93,000 in March and 133,000 in April 1950.

DISTRIBUTION

Total retail sales decreased further in April. In the early part of May, department store sales of durable goods slackened somewhat further, while sales of apparel and most other nondurable goods were maintained. Department store stocks at the end of April continued at the advanced level reached at the end of March and were nearly one-third above the corresponding period in 1950.



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



Federal Reserve indexes. Monthly figures; latest figure for sales is April; latest for stocks is March.

COMMODITY PRICES

Prices of 28 basic commodities have declined further since the end of April, and on May 25 were 7 per cent below the February peak but 38 per cent higher than a year ago. Reflecting mainly declines in basic materials, the general level of wholesale commodity prices has decreased slightly since the end of April. Prices of finished goods have generally changed little.

Consumer prices in mid-April were maintained at the March level. Prices of foods declined slightly but apparel, housefurnishings, and rents increased somewhat further.

BANK CREDIT AND THE MONEY SUPPLY

Bank loans to business in leading cities showed little change from mid-April to the third week of May, although there is usually a decline at this season. Credit extended for defense purposes continued to be substantial. Wholesalers and retailers also borrowed substantial amounts, while commodity dealers made large repayments on loans.

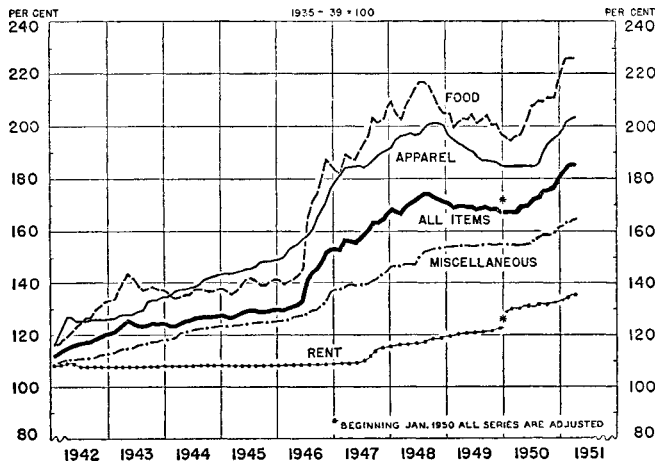
Deposits and currency held by businesses and individuals increased substantially in April, reflecting largely a shift of funds to private accounts as Treasury balances were reduced following the heavy inflow of tax receipts in March. At selected banks in leading cities outside New York the rate of use of demand deposits rose somewhat further.

Member bank reserve balances declined between early April and mid-May, reflecting gold and currency outflows, cash redemption of part of Federal Reserve holdings of the weekly maturing Treasury bills, and increases in Treasury deposits at the Reserve Banks.

SECURITY MARKETS

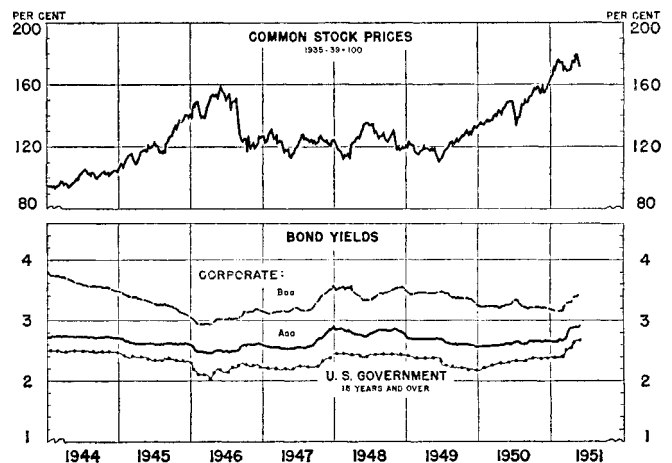
Common stock prices reached a new postwar high early in May but subsequently declined to the lowest level since mid-January. While yields on Treasury securities increased somewhat in the first three weeks of May, there was little net change in yields on high-grade corporate bonds.

CONSUMERS PRICES



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

SECURITY MARKETS



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 May 19.