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MONEY MARKET IN JUNE

After having been unusually tight through most of May, the money market turned sharply on June 1 and remained easy until the closing week of the month. The principal easing influences arose from public debt transactions of the Treasury, from Federal Reserve System purchases of called or maturing Government securities, and from an unusual rise in the volume of uncollected checks (for which the Reserve Banks had already given credit in member bank reserve accounts) which was accentuated by a labor dispute that interrupted some important air transportation services. Most of the increase in member bank reserves occurred during the first week of the month, when the banks were also able to repay a large part of the advances they had obtained from the Reserve Banks in May. Moreover, the customary stringency associated with a quarterly tax payment date was relieved in the period following June 15 by the Treasury's further use of a new technique for delaying the transfer of tax collections from the banks into Treasury deposits at the Reserve Banks. There was an eventual tightening toward the close of the month, however, as the volume of "float" (credits to member bank reserves for uncollected checks) declined abruptly, the Treasury began calling its deposits in commercial banks for transfer into the Reserve Banks, and the release of funds through System purchases of Government securities subsided. As a result, the earlier growth in excess reserves of member banks was largely eliminated, member bank borrowings increased moderately, and the rate on Federal funds was again relatively high after the 22nd.

PUBLIC DEBT TRANSACTIONS

On June 1 it became profitable for a large proportion of the holders of the old Series D Savings notes to redeem them for cash and purchase the new and considerably more attractive Series A notes (which the Treasury had begun offering for sale in May). Actually, cash redemptions on the first of the month were about 2.1 billion dollars, while sales amounted to about 1.8 billion, thus resulting in an increase of roughly 300 million dollars in bank reserves. The occurrence of large redemptions and simultaneous sales at this time had been anticipated, and temporary informal arrangements were made to handle the operation in a manner comparable with an exchange of marketable securities. Instead of crediting sales proceeds to Treasury Tax and Loan Accounts in the commercial banks, both the redemption of old notes and the sale of new notes in instances of such switching were to filter through the Treasury's accounts with the Reserve Banks without materially affecting the banking system. However, because of the technical difficulty in these circumstances of matching their sales of new Savings notes to individual customers against redemptions of the old notes by those customers, some banks treated a substantial volume of sales as new subscriptions instead of exchanges. Thus these banks retained for temporary investment at least a part of the proceeds of the redemption of the old series of Savings notes turned over to them by their customers in payment for the new notes. The Treasury undertook to regain a considerable part of these funds by issuing special calls on the specific banks involved. But these calls came too late to avoid temporary Treasury borrowing from the Reserve Banks in order to cover the excess of redemptions over the return flow of funds into the Treasury's account at the Reserve Banks. Thus, on June 1, the Treasury sold 100 million dollars of special certificates to the Reserve Banks, and liquidated them the next working day.

On May 28 the Secretary of the Treasury had announced that the 1.6 billion dollars of 2¾ per cent partially tax-exempt bonds called for June 15 and the 8.4 billion dollars of 1¼ per cent Treasury notes maturing July 1 would be exchanged on June 15 for a 1⅞ per cent 9½ month certificate of indebtedness. The books were open for this exchange from June 4 through 7. On completion of the conversion, the Secretary

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reported that less than 6 per cent of the ten billion dollar total had been presented for cash redemption. This represented a Treasury disbursement of 110 million dollars on June 15 for the called bonds and indicated a further disbursement of 435 million dollars on July 1 for the maturing notes.

Government Security Market

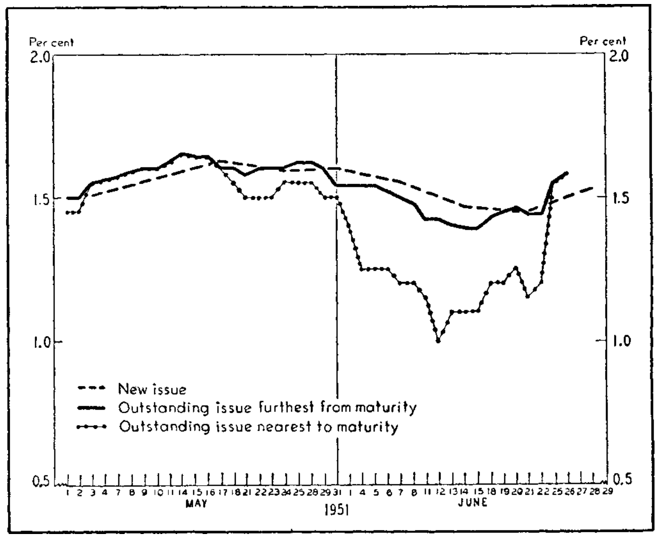
In order to facilitate refunding in the market by holders of the called or maturing Government securities who required cash or very short-term investments, despite the attractive terms of the Treasury's exchange offering, the Federal Reserve System purchased the "rights" to the new offering, as well as some of the new certificates on a "when-issued" basis. As a result, System net purchases of Government securities for the first two statement weeks of the month aggregated 465 million dollars. Net purchases later in the month were small—85 million dollars. Largely because of their gain in funds from System purchases, the banks paid back (net) 320 million of their advances from the Reserve Banks over the four statement weeks ended June 27.

Among the investors switching out of maturing or called issues (i.e., the "rights" to subscribe to the new issue) were those nonbank investors whose maturity requirements are of very short term and those in need of cash to pay taxes on June 15. Some investors subscribed for the new certificates, but then in turn sold them on a "when-issued" basis for delivery June 15. "When-issued" sales, however, were much smaller than the sale of the "rights". In addition, commercial banks in need of funds early in the month to adjust their reserve positions, liquidated sizable amounts of the maturing notes which they could sell more advantageously than most other securities they held. Still other investors, who wished to maintain their positions in partially tax-exempt bonds, disposed of considerable amounts of the called bonds in order to reinvest the proceeds in other partially tax-exempt issues. Prices of the entire list of partially tax-exempt bonds consequently moved up moderately during the first half of the month, although they declined thereafter.

Because the pressure of demand was heaviest on the shorter maturities of Treasury bills and the August 1 Treasury notes, the yield on the nearest maturity bills (as shown in the accompanying chart) declined sharply and reached a low of 1 per cent bid on June 12, as compared with 1½ per cent at the end of May and the recent peak of 1.65 per cent on May 14. Yields on the longer maturities of Treasury bills fell more moderately, and the yield spread between the longest and shortest maturities widened markedly over the first three weeks of the month, as illustrated in the chart. The drain on bank reserves from tax collections, Treasury calls on its Tax and Loan Accounts, and other transactions brought an increase in yields and closed the gap toward the end of the month.

There was very little activity in the market for longer-term

Yields on Treasury Bills
(Daily, May 1-June 26, 1951*)



* Saturdays, Sundays, and Decoration Day (when no trading occurred) are omitted.

Government securities during the greater part of the month, and most prices fluctuated over a limited range with some tendency toward a slight decline. The shortest of the restricted issues fell off in price about 1/8 of a point, and the longer issues from 1/16 to 1/8 of a point over the month as a whole. However, the longest-term bank-eligible bonds, the 2½'s of September 1967-72, declined during most of the month, and toward the close of June were more than one point lower than at the end of May.

Member Bank Reserve Positions

The major changes in member bank reserves came in the first and fourth statement weeks of June; the bulk of the gains occurred in the first week, and the bulk of the losses in the fourth week. Little net change occurred in the intervening period as transactions furnishing additional reserves were more or less offset by those absorbing funds.

The ease in the money market in the week ended June 6 resulted, as noted above, from the new funds which became temporarily available to the market owing to the cash redemption and conversion of Treasury Savings notes on June 1, and from the System Account's purchases of the called and maturing issues. The resulting gains from these sources and from routine money market transactions, on balance, including a 200 million dollar increase in Federal Reserve float, permitted the banks to retire 410 million dollars of their indebtedness to the Reserve Banks and to increase their excess reserves by 560 million dollars. On June 6, excess reserves amounted to 860 million dollars and borrowings to only 130 million. The corresponding figures on June 20, two weeks later, were 825 million dollars and 165 million, respectively. The individual factors which more or less offset each other as influences upon

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bank reserve positions through the second and third weeks of the month are summarized in the accompanying table.

In the final week, continued payments of income taxes and transfers from Tax and Loan Accounts into the Treasury's accounts with the Reserve Banks, a sharp month-end reduction of Federal Reserve float, and the beginning of the pre-holiday (July 4th) outflow of currency all combined to tighten member bank reserve positions, resulting in renewed borrowing from the Reserve Banks and a sharp decline in excess reserves. Federal funds were quoted at 1½-1⅝ per cent on June 25 and remained firm in the closing days of the month.

The impact of the payment of quarterly income taxes on member bank reserve positions was much less severe than in the past, despite the sharply higher volume of taxes this year, for reasons which are more fully explained in the article on the Treasury's handling of its cash balances which appears at a later point in this *Review.* The lessened impact of tax collections was due to the renewal of the Treasury's practice, first begun with the March 15 tax payments this year, of redepositing the proceeds of corporate income tax checks of 10,000 dollars or more in a special account maintained in the bank on which such checks were drawn. In June, the practice was extended to include the large checks of individual taxpayers.

A corollary effect of the new practice of handling income tax payments has been to shift private deposits to Government deposits, and thus minimize the decline in required reserves which normally occurs in connection with tax payments that are fully credited to the Treasury's accounts in the Reserve Banks. Thus in the week ended June 27, the decrease in required reserves came to only 45 million dollars. In the preceding three weeks of easy money conditions, however, required reserves rose 450 million dollars and represented the major factor absorbing excess reserves. This increase reflected principally the net Treasury redemptions of Savings notes and the Federal Reserve System net purchases of Treasury securities, both of which tended to add to the bank deposits of nonbank investors.

Weekly Changes in Factors Tending to Increase or Decrease Member Bank Reserves, June 1951

(In millions of dollars; (+) denotes increase, (—) decrease in excess reserves)

Factor	Statement weeks ended				Four weeks ended
	June 6	June 13	June 20	June 27	June 27
Routine transactions					
Treasury operations*	+474	+ 27	−299	+ 16	+218
Federal Reserve float	+200	+ 81	+333	−327	+287
Currency in circulation	− 59	+ 21	+ 20	−122	−140
Gold and foreign account	− 4	− 13	+ 7	− 42	− 52
Other deposits, etc	+129	+ 18	−100	+ 1	+ 48
Total	+740	+134	− 40	−472	+362
Federal Reserve transactions					
Government securities	+360	+105	+ 48	+ 37	+550
Discounts and advances	−411	+ 50	− 13	+ 55	−319
Total	− 50	+155	+ 35	+ 92	+232
Total reserves	*+690*	*+289*	*− 5*	*−380*	*+594*
Effect of change in required reserves	*−128*	*− 65*	*−255*	*+ 45*	*−403*
Excess reserves	*+562*	*+224*	*−260*	*−335*	*+191*

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

The country's monetary gold stock continued to show little net change for the third successive month. While the decline of the gold outflow has greatly reduced one source of contraction affecting member bank reserves, another has taken its place in some measure. Money in circulation this year has increased more rapidly since the post-Christmas decline than in the corresponding period a year ago. Between the end of January and the close of June 1951 the volume of currency in use rose by more than 700 million dollars, as against a corresponding increase of only 215 million in 1950. Higher prices, wages, and a larger volume of retail sales are probably major factors in the expansion of circulation this year.

THE FINANCING OF BRITISH REARMAMENT

The acceleration of defense efforts throughout the Western world since the outbreak of the Korean war has had important repercussions on the British economy. As in other countries, the developments of the past year have tended to increase inflationary pressures and are expected to affect adversely the country's balance of payments. This article will discuss the impact of these developments on Britain's domestic economy, giving particular emphasis to the government's proposed budget for 1951-52, under which the new defense program announced by Prime Minister Attlee last January is to be carried forward. Another article in a subsequent issue of this *Review* will discuss the implications of these developments for Britain's international economic position.

The adoption of the new defense program, which calls for the expenditure of 4,700 million pounds during the next three fiscal years, has brought about a major change in the government's financial position. While the budgetary accounts have shown substantial over-all surpluses during the last three fiscal years—the surplus in the past year was 247 million pounds—Chancellor of the Exchequer Gaitskell has estimated that in the year ending next March 31 the budget will run a deficit of 457 million, as shown in Table I. Government expenditures are expected to expand by almost 1,000 million pounds to 4,777 million, or to about 33 per cent of the estimated 1951 gross national product, as against 28 per cent last year. Defense expenditures alone (including strategic stockpiling and the defense functions of the Ministry of Supply) are to increase by 636 million pounds to 1,417 million, equivalent to about 10 per cent of the estimated gross national product, or about the same proportion as is currently being expended for defense by the United States.

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Table I
United Kingdom Central Government Revenue and Expenditure
(In millions of pounds; fiscal year ended March 31)

Item	1951-52 estimates on basis of		1950-51	
	1951-52 taxes	1950-51 taxes	Actual	Original estimate
Receipts:				
Ordinary revenue	4,236	4,098	3,978	3,898
"Below the line" receipts	84	84	73	70
Total receipts	4,320	4,182	4,051	3,968
Expenditure:				
Ordinary expenditure	4,197	4,197	3,258	3,455
"Below the line" payments	580	580	546	520
Total expenditure	4,777	4,777	3,804	3,975
Surplus (+) or deficit (−):				
Ordinary revenue and expenditure	+ 39	− 99	+720	+443
Total revenue and expenditure	−457	−595	+247	− 7

Source: United Kingdom Treasury, *Financial Statement (1951-52)*.

The proposed budget contains no important expenditure cuts to offset the large increase for defense. Social welfare expenditures continue upward, although the rise this year has been held to a very moderate sum. Small increases in pensions and other allowances are granted to old people and others least able to bear the impact of rising prices. At the same time, however, the government has adopted measures to postpone the age at which both men and women retire from the labor force, and, in a move to limit the rising cost of the health service, has decided to impose a fee to cover part of the cost of artificial teeth and spectacles. Food subsidies, moreover, are to remain unchanged at the 1950-51 level of 410 million, which means that the cost of living will receive the full impact of the rise in import prices.

Less than one third of the increase in expenditures is to be offset by higher revenues, which are expected to yield 4,320 million pounds, an increase of 269 million pounds over actual revenues of 4,051 million in 1950-51. The anticipated revenue increase is attributable in roughly equal proportions to the scheduled increases in tax rates, and to the prospective expansion of the national income. Personal and corporate income tax rates are to be raised by a half shilling on the pound; a cut in the top rate of the surtax will result in no change in the tax burden of those in the top surtax bracket, however, while the concession of larger deductions for dependents will actually reduce the tax load carried by many individuals in the lower income tax range. Taken together, these changes in the income tax are expected to increase income tax collections by 73 million pounds in the current fiscal year. Higher customs and excise taxes, particularly on gasoline, new cars, and consumers' durable goods, are to raise an additional 61 million; and an increase to 50 per cent from 30 per cent in the tax on distributed profits is expected to yield 5 million.

The government's revenue proposals are accompanied by a number of measures designed to curb tax evasion. Perhaps the most important of these would forbid any British company to transfer its own residence abroad or to permit any overseas firm controlled by it to issue or transfer any stocks or bonds except with Treasury approval. Another proposal to curb tax evasion would grant the Treasury authority to require banks and discount houses to supply the names and addresses of individuals who have received interest payments of £15 or more, before tax, in any specified year. Critics of this measure have observed that the number of personal deposits averaging £3,000 or more (thus yielding £15 at ½ per cent) is probably relatively small, and have accordingly raised the question as to whether the gain to the Treasury would sufficiently compensate for the additional administrative burden that would thus be thrust on the banking system.

In appraising the possible inflationary implications of the budget, Mr. Gaitskell pointed out that the prospective shift from an over-all surplus of 247 million pounds to an over-all deficit of 457 million did not provide a true measure of the deterioration in the government's financial position. Thus, the budgetary estimates include projected outlays for stockpiling and other capital items which, for purposes of analyzing the budget's inflationary significance, should be considered as a part of over-all national investment instead of current governmental expenditure. After excluding these capital items from his budgetary estimates, Mr. Gaitskell estimated that the net deterioration in the government's financial position (after allowance for the new taxation) would approximate 340 million pounds.

The inflationary impact of this adverse shift in the government's financial position will, according to Mr. Gaitskell's estimates, be fully absorbed by a decline in foreign investment and by a rise in business savings. In effect, the public is expected to invest less and save more in order to make room for the heavier financial requirements of the government.

Much of the compensating adjustment on the investment side is to be effected through changes in Britain's international balance of payments. Thus, the balance-of-payments surplus on current account in the last financial year, provisionally estimated at 200 million pounds, represented net foreign investment; the Chancellor estimates that this investment will be eliminated in 1951-52.

Domestic investment by private individuals and firms is also expected to decline substantially in 1951-52. The Treasury has instructed the Capital Issues Committee and the banks to curb capital outlays not considered essential for defense and foreign trade purposes, and Mr. Gaitskell has expressed the

A DAY'S WORK AT THE FEDERAL RESERVE BANK OF NEW YORK

A booklet entitled *A Day's Work at the Federal Reserve Bank of New York* is now available free of charge to anyone interested in receiving a copy. It describes the wide range of activities that are carried on by this bank and the important functions which the Federal Reserve System performs in our present-day "money economy". Requests for copies should be sent to the Public Information Department, Federal Reserve Bank of New York, New York 45, N. Y.

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Table II
British Economic Indicators

Year or month	Industrial production	Money supply, end of period	Long-term interest rates	Physical volume of: Exports	Physical volume of: Retained imports	Export prices	Import prices	Wholesale prices	Retail prices	Wage rates
	1946 = 100	In billions of pounds	Per cent	1947 = 100		1950 = 100		1938 = 100	June 17, 1947 = 100	June 30, 1947 = 100
1948	121	5.12	3.21	127	105	92*	83*	216	108	106
1949	129	5.19	3.30	140	114	94	85	227	111	109
1950	140	5.28	3.54	162	114	100	100	259	114	111
1951-January	140	5.22	3.53			107	119	296	117	115
February	150	5.05	3.64	160	120	109	125	301	118	116
March	140	5.04	3.67			112	128	309	119	117
April	151p	5.13	3.73	182p	n.a.	115	136	314	121	118
May	n.a.	n.a.	3.81†	n.a.	n.a.	118	142	315	124	n.a.

n.a. Not available. p. Provisional. * Estimated; not strictly comparable with rest of series. † May 30.
Source: Central Statistical Office, *Monthly Digest of Statistics*, May 1951; The Economist, *Records and Statistics*, June 2, 1951; International Monetary Fund, *International Financial Statistics*, May 1951.

hope that the recent rise in interest rates (see Table II) will also have a restraining influence. With a view to limiting private investment next year and thereafter, the Chancellor also announced the government's intention to suspend, as of April 6, 1952, the initial depreciation allowance for income tax and profits tax purposes of 40 per cent on plant and machinery and of 10 per cent on industrial buildings, mines, and oil wells; this change would not affect ordinary annual depreciation charges, which would continue to be deductible from gross taxable income and profits as before. Mr. Gaitskell stated that the year's grace was given in consideration of the time that industry would need to adjust its investment plans; the government has subsequently indicated that this grace period might be extended for the shipbuilding industry, whose investment plans necessarily reach far into the future. These measures to restrain private domestic investment are expected to offset all but 30 million pounds of the projected increases in domestic investment by the central government. On balance, over-all investment—both foreign and domestic—is expected to decline by 170 million pounds.

So far as savings are concerned, Mr. Gaitskell estimates that business savings will rise 200 million pounds above the level of the fiscal year 1950-51. Corporations and other business enterprises are expected to increase substantially the amounts that are put aside to cover depreciation of capital, to provide for future tax payments on currently earned profits, and as free reserves. In this connection, the Chancellor estimated that, by putting a damper on dividends, the increase in the tax on distributed profits would raise corporate savings some 30 million. In view of the rising cost of living, on the other hand, personal savings were not expected to show any increase. Moreover, the savings of local authorities and social insurance funds are expected to decline by 15 million pounds.

On balance, the anticipated net increase in savings, i.e., 185 million pounds, in combination with the expected decline in investment of 170 million pounds aggregates 355 million pounds, or somewhat more than the prospective deterioration in the government's financial position. On the basis of these estimates, Mr. Gaitskell concluded that over-all saving would be adequate to finance over-all investment, and that, despite the large change in the government's budgetary position, additional inflationary pressure—apart from the impact of rising import prices—could be avoided.

Mr. Gaitskell's first budget has been widely discussed in British financial circles, and searching questions have been raised about the economic forecasts on which it is based (see Table III). Particularly important is the forecast that industrial production in 1951 can be maintained at approximately the level attained in the final quarter of last year, or about 4 per cent above the 1950 average. Critics have been quick to observe that the government's *Economic Survey for 1951* itself stated that Britain could not count on getting the raw materials to support such a level of production. During the first quarter of this year, indeed, industrial output fell slightly below the Chancellor's goal, as Table II indicates.

British observers have also questioned whether the government has not been somewhat optimistic in estimating that the balance of payments will change from a 200 million pound surplus on current account in 1950-51 to a deficit of only

Table III
United Kingdom Gross National Product and Expenditure
(In millions of pounds)

Item	Forecast for 1951: At current prices	Forecast for 1951: At 1950 prices	1950: Actual	1950: As forecast in Economic Survey for 1950	1949, actual
National product:					
Gross national product	14,500	13,897	13,572	13,345	12,933
Balance-of-payments surplus (−) or deficit (+)	+100a	−145ab	−229	−50	−30
Disposable product	14,600	13,752	13,343	13,295	12,903
National expenditure:					
Gross domestic investment	2,415a	2,336ab	2,277	2,435	2,297
Government current expenditure on goods and services	2,510	2,425	2,025	2,220	2,039
Personal consumption	9,675	8,991	9,041	8,640	8,567
Total domestic expenditure	14,600	13,752	13,343	13,295	12,903

a. Includes strategic stockpiling.
b. Partly estimated.
Source: *Economic Survey for 1950* (Cmd. 7915), page 20; and *Economic Survey for 1951* (Cmd. 8195), pages 34, 38, and 41.

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about 130 million in 1951-52. Realization of the government's forecasts will require, according to the *Economic Survey,* not only an 18 per cent rise in export prices over 1950 and a 5 per cent increase in the physical volume of Britain's exports, but also a limitation of the import price rise to no more than 28 per cent. Actually, import prices in May had already risen 42 per cent above the 1950 average, while export prices were up only 18 per cent. In contrast to the seasonal pattern of recent years, moreover, the physical volume of exports in the first quarter of this year dropped slightly below the 1950 average. Whether labor shortages and booming raw material prices, as well as the pressure of expanding defense and civilian demand, will vitiate the government's balance-of-payments forecast is therefore still a moot point.

In formulating his budget, Mr. Gaitskell also assumed that personal incomes would increase more slowly than the cost of living, and that the volume of personal consumption would consequently fall in 1951, thus releasing productive resources for defense purposes. There were signs during the first four months of 1951 that this expectation was being realized, although most of the pinch seems to have been felt by salaried individuals and pensioners whose incomes normally rise relatively slowly in inflationary periods; on the other hand, wage rates since last September seem to have been keeping pace with the rise in retail prices.

Economic forecasts are naturally subject to wide margins of error, and Mr. Gaitskell appears to have made extensive allowances for the unexpected in preparing his budget. Thus, estimates of forthcoming revenue appear relatively conservative, while those on the expenditure side may well overstate the amounts that will actually be spent. Although an increase in the gross national product of over 900 million pounds had been officially forecast (see Table III), the Treasury has calculated that revenues on the basis of 1950-51 tax rates would rise only 131 million pounds, or by 14 per cent of the rise in the gross national product. In view of Britain's high tax rates (27 per cent of personal incomes was collected in taxes in 1950), it would not be surprising if revenue actually rose somewhat more than has been estimated.

As to expenditures, inevitable delays in getting the defense program under way, such as the difficulties in the conversion of industry and in the negotiation of contracts that have developed in the United States, may well occur, and it is therefore possible that not all the funds already appropriated for defense will actually be paid out of the Exchequer before the end of the current fiscal year. Moreover, the government has included in its estimates 160 million pounds for defense that Parliament has not yet been asked to appropriate. Should delays be experienced in expending the funds already granted, or should the country experience serious inflationary difficulties, the request for these additional funds may not in fact be made. It is therefore quite possible that the over-all budget deficit may turn out to be somewhat smaller than Mr. Gaitskell's forecast of 457 million pounds. By the same token, however, the government would seem to have left itself room for maneuver in case its forecasts of the amount of private saving, or of the increase in production, should prove wide of the mark.

THE DEFENSE PROGRAM IN TRANSITION

At the conclusion of the first year of the Korean war, this country finds itself experiencing a lull following the initial period of strong inflationary pressures. We have just completed a year of preparation for large-scale defense production, but throughout this period the economy has—to a far greater extent than was generally expected—been dominated by changes in civilian demand, rather than by the defense program itself. Defense activity has not yet made great demands on materials and manpower, since the major emphasis thus far has been on the planning of requirements, the letting of contracts, and the preparation of facilities. In the months ahead, so long as there is no reversal of present plans for rearming, output of defense goods and capital equipment will claim an increasingly important share of the nation's productive capacity. Renewed inflationary pressures growing out of increasing diversion of production to defense purposes, coupled with a rising volume of consumer income, are generally anticipated over the next year.

Recent Developments

The pause in the general advance during recent months has, however, been a helpful and welcome interruption. Sales, production, and prices have leveled off, or in some cases have receded somewhat. Prices, at all levels of distribution, have remained fairly stable or declined since early spring. Retailers, with stocks high and sales lagging, have found intensified promotional measures necessary to stimulate the interest of consumers, who earlier this year were more than eager to buy. Materials restrictions and reduced demand have caused some cutbacks in consumer goods production, tending to offset the gradual rise in output of goods for the defense effort and related programs.

The leveling off in prices may, to some extent, be attributed to the influence of price controls. But the tenor of the markets in the last few months has indicated that a softening in the demand for goods has been of fundamental importance in keeping most prices within the controlled limits. There have been few cases reported thus far in which demand has been so intense as to give rise to large-scale black markets. In fact, prices of a number of basic commodities have receded from their ceilings, prices for future delivery have dropped even more markedly, and at the retail level price cuts, rather than black markets, are making the headlines. Even with the reduced supply of beef currently available, reports have emphasized consumer resistance to high ceiling prices more than extra-legal sales at still higher prices.

The lull in demand has occurred not only at the consumer level but at the distributive and industrial levels as well. To

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a considerable extent it represents a reaction from the buying spree in which both consumers and businessmen indulged last summer and again last winter. Fears of shortages, lower quality, or higher prices then caused consumers to rush to the stores, particularly for durable goods. Consumers showed great willingness to spend a larger share of their incomes, to dip into accumulated savings, or even to go into debt in order to obtain the goods they wanted. Businessmen, too, bought heavily. Many dealers had concluded early in the defense program that large inventories would be advantageous in view of the prospects for increased consumer income and greater curtailment of civilian goods production later in 1951. Their efforts to acquire these stocks were accompanied in many instances by expansion of bank credit, and, like consumer buying, contributed to higher prices.

Meanwhile the nation's industrial plants continued to pour out a far greater volume of consumer goods than had been considered possible. The military situation in Korea improved materially. Consumers soon realized that the supply and price situation was not worsening as much (or as rapidly) as they had originally feared, and retail sales slackened off appreciably during the spring months. Dealers' stocks piled up despite sharp cuts in new orders. Often deliveries were received on orders which were not expected to be filled for a number of months. Wholesalers and manufacturers also experienced involuntary accumulation of inventories. As a result, many firms, particularly in the consumers' durable goods field, had to liquidate inventories, in part because of shortages of local storage space and sometimes because of pressure from the banks to shorten doubtful inventory positions. The program of voluntary credit restraint and recent general measures to restrict the availability of bank credit may have played a part in stimulating a critical surveillance of inventories by the banks and their customers.

In the New York City area, in particular, retailers have tried such devices as public auctions and extensive price cutting to revive lagging consumer interest. The competitive price cutting on merchandise for which prices were formerly fixed by the manufacturers under "fair-trade" laws has resulted in year-to-year gains of as much as 21 per cent in New York City department store sales. The buying rush that developed has been quite unlike the scare buying of July and January, however; consumers are buying, not from fear of shortages, but because desirable merchandise is selling at attractive prices. The widespread interest in the items on sale demonstrates that, despite the earlier waves of anticipatory buying, there is still a sizable backlog of demand for these goods—if the prices are attractive. Though the currently highly competitive behavior of local stores is more typical of a deflationary than an inflationary period, the rush of consumers to buy indicates that they do not expect further general declines in prices or even continued bargain prices. In addition, the sharp upswing in sales offers a reminder that the huge inflationary potential of high levels of income and accumulated savings is still present and, as was the case last summer and again last winter, a change in consumer attitudes can swiftly change the economic situation.

The flow of consumer goods has, up to the present, been more than adequate to meet the demand, in spite of limitations on the use of scarce materials. For instance, more than 3 million passenger cars rolled off the assembly lines in the first half of 1951, one of the largest six-month totals on record. The changes in consumer goods output have dominated the course of industrial production during the past year, while actual production of defense goods has been relatively small but growing. Even more important in maintaining the level of output this spring has been the large-scale plant and equipment expenditure carried out by business for both defense and nondefense purposes. These expenditures have more than offset in dollar volume (and in utilization of manpower) the scattered consumer goods cutbacks resulting from slackening in demand, materials shortages, and conversion of facilities to defense work. Over all, the level of industrial production has remained very stable, advancing only 1 per cent from January to May. As defense production gathers momentum, an increasing proportion of civilian goods output will be displaced. Total defense expenditures, which accounted for about 4½ per cent of the total national output of goods and services before Korea and 8 per cent in the first quarter of this year, are expected to take about 15 per cent of the gross national product by the end of 1951.

Defense Activity in the Second District

The impact of the defense program has, of course, varied considerably from one area or locality to another. The Second Federal Reserve District has received what appears to be its proportionate share of defense work, if not more, and many defense plants are scheduled for construction, expansion, or reopening. Defense activity in this region will be centered mainly in electrical equipment, aircraft, shipbuilding, and primary metals, as it was during World War II. Major defense contracts awarded in this area so far cover a widely diversified list of items, but some of the largest awards have been for aircraft engines, tanks, and jet planes. In general, durable goods centers, such as Buffalo, Bridgeport, Schenectady, Syracuse, and Long Island, have experienced an increase in production and a tightening of the labor market. However, because of the Second District's large concentration of consumers' nondurable goods manufacturing, trade, and service industries, the defense boom is far from general in this area. Cities producing mainly nondurable goods, such as New York City, Utica, and Binghamton, have as yet felt relatively little effect from defense production. The many small industries in the New York City area are unlikely to benefit much until the volume of subcontracting has been greatly expanded. While this District is currently prosperous and is likely to remain so, it may (as in World War II) fail to keep pace with the increases in other industrial areas once defense production gains momentum.

A large number of defense industries in this District have qualified for certificates of necessity, enabling them to amortize

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new plant and equipment at an accelerated rate. In addition, a great deal of expansion of civilian production facilities has been planned, although much of this might also be available for war production. In New York State alone, according to the State Department of Commerce, the amount of new industrial construction for which plans have been filed since the outbreak of war in Korea totals over 1 billion dollars. Chief among these plans is the 75 million dollar steel mill expansion planned for the Buffalo area. Other large projects have been announced for the manufacture of electronic equipment in several Central New York cities, aluminum in Northern New York, aircraft on Long Island, and petroleum products, television, and automobiles in Northern New Jersey. Large World War II plants are being converted to the manufacture of aircraft engines in the Buffalo and Bridgeport areas. In addition, several military installations in this District have expanded or reopened.

The Economic Outlook

The large-scale expansion of facilities, occurring in the country as a whole as well as in this District, parallels the experience of the early stages of World War II. The armament program then passed through three phases, the dominant characteristic of the first phase being shortages of defense production facilities; of the second, shortages of materials; and of the third, shortages of manpower. All parts of the present defense program do not progress at the same speed, and there tends to be considerable overlapping of these stages among various sectors of the economy. Nevertheless, the more stringent restrictions on use of scarce materials for nonessential purposes scheduled to be imposed in the third and fourth quarters of 1951 indicate that most of the economy will soon be passing from the first to the second phase of the defense program, within little more than a year after the program's inception. The first phase—the placing of contracts and the conversion or tooling up of facilities—is well under way, and the additional facilities now being built will supplement an already strong defense production potential. In the months ahead, defense goods will be coming off the assembly lines in ever-increasing quantities, and shortages of raw materials are likely to be among industry's most pressing problems.

The first phase has been much shorter in duration than it was in World War II, because this time we had a vast amount of specialized defense facilities, such as shipyards, aircraft factories, and ordnance plants, left over from World War II. Because of the huge postwar expenditures on capital equipment, this country's industrial plant was in far better shape in 1950 than in 1940. However, the prospects both of expanded defense production and of a continued high level of consumer demand have led to plans for considerable further expansion by private business. In cases where the defense program will eventually be aided, the Government is encouraging expansion by allowing accelerated amortization on new facilities or by allocating materials for the manufacture of equipment. In other cases, where the new facilities appear to be less essential, their construction is being discouraged through both credit restrictions and materials controls. The plant and equipment expenditures to be made in coming months will compete for materials with the output of consumer goods and the growing volume of defense production. For example, in order to expand steel production, sizable quantities of steel are required, making supplies temporarily even tighter until the new facilities come into production. When capacity for the production of various basic materials begins to expand more rapidly than defense needs, some of the limitations on the use of these materials may be eased—provided the defense program stays within its present scope—but such developments are unlikely for some time to come.

In the interim, however, defense production and plant expansion are likely to cut increasingly into the supply of materials available for consumer goods. At the same time, output of defense materials and capital goods will be generating additional consumer income. As employment and wages advance, it is likely that the demand for consumer goods will also rise. Although the large current inventories may help to offset the decline in output of consumer goods, the danger of renewed inflationary pressures will be steadily increasing. Unless there should be a lessening of international tension, with an important modification in consumer and business attitudes, these pressures can be expected to subside only after the economy has passed "over the hump" of expanding defense output.

NATIONAL DEFENSE EXPENDITURES

In view of the growing importance of the national defense program, a series on national defense expenditures has recently been added to the data regularly appearing in the table of Business Indicators. This series covers a group of related security programs as well as the military outlays of the armed forces. By following the general principle of including related and allied programs whenever such data were available, a consistent set of data on defense expenditures has been prepared from 1914 to the present.

This series currently includes, in addition to the military outlays of the Defense Department, spending for atomic energy, mutual defense assistance, strategic and critical materials, and for several smaller but related programs.[1] Expenditures for United Nations Relief and Rehabilitation and the early spending for government and relief in occupied countries after World War II have been included. For the years 1940 to 1946 (inclusive) the war-related activities of the Reconstruction Finance Corporation and its affiliates as well as comparable activities of other Government departments have been taken into account. In all essential aspects this is the

[1] Maritime activities by the Commerce Department (formerly the Maritime Commission), the Coast Guard, the National Advisory Committee for Aeronautics, the Selective Service System, and cash payments and the redemption of bonds under the Armed Forces Leave Act.

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series that was developed and used during World War II by the War Production Board. During the period 1922-39, the programs allied to defense were limited and only expenditures by the Maritime Commission (known as the U. S. Shipping Board until 1939) and a relatively small amount of payments and receipts carried over from miscellaneous war activities of World War I have been included. In the period dominated by World War I, 1917-21, substantial expenditures were made for related programs. Large loans were made to our allies and these have been included in the series along with the spending by the United States Shipping Board and the War Finance Corporation, as well as Federal expenditures for the control of transportation. In the years 1914-16, there were no war-related programs.

The data included in this series on national defense expenditures can be obtained from this bank on an annual basis for the fiscal years, 1914 to date, and on a monthly basis for the period since July 1939.

Since March 1951, a related series showing the quarterly deliveries of defense items from 1949 to date (at an annual rate as compiled by the Department of Commerce) appears as Government purchases of goods and services for national defense in the *Economic Indicators* prepared by the Council of Economic Advisers. Information on the deliveries of war goods and services has been published both on a quarterly and an annual basis from 1939 through 1946 in the July 1950 *Survey of Current Business* (Department of Commerce).

Defense outlays rose slowly during the early months of the renewed armament effort, as shown in the accompanying chart. Following a fairly rapid step-up during the past nine months, defense outlays are expected to level off so that the over-all rate of increase through mid-1952 will be considerably less than that achieved during the comparable period of World War II.

During the past year it was unavoidable that appropriations and contracts should expand more rapidly than expenditures. A striking example of this difference in timing was evident during the first quarter of 1951 when expenditures of all types averaged less than 2 billion dollars monthly while orders were being placed at an average monthly rate of 5 billion. There are many causes for this type of behavior. A principal consideration is the inescapable fact that the manufacture and delivery of some of the goods ordered under the new program, particularly heavy military equipment, require many months. In some cases, payments are made as production progresses; in other cases, production is financed by the manufacturers out of

Business Indicators

Item	Unit	1951			1950	Percentage change	
		May	April	March	May	Latest month from previous month	Latest month from year earlier
UNITED STATES							
Production and trade							
Industrial production*	1935-39 = 100	223*p*	223	223*r*	195	#	+ 14
Electric power output*	1935-39 = 100	320	325	323	284	− 2	+ 13
Ton-miles of railway freight*	1935-39 = 100	197*p*	219*p*	205	173	−10	+ 13
Manufacturers' sales*	billions of $	23.5*p*	22.4	23.4	19.3	+ 5	+ 22
Manufacturers' inventories*	billions of $	38.8*p*	37.9	36.4	29.7	+ 2	+ 31
Manufacturers' new orders, total	billions of $	23.2*p*	23.9	28.6	19.1	− 3	+ 21
Manufacturers' new orders, durable goods	billions of $	11.5*p*	12.6	15.5	8.5	− 9	+ 35
Retail sales*	billions of $	12.0*p*	12.0	12.3	11.3	#	+ 6
Residential construction contracts*	1923-25 = 100	269*p*	283	292	303	− 5	− 11
Nonresidential construction contracts*	1923-25 = 100	409*p*	446	314	250	− 8	+ 64
Prices, wages, and employment							
Basic commodity prices†	Aug. 1939 = 100	367.1	373.9	380.9	259.1	− 2	+ 42
Wholesale prices†	1926 = 100	182.8*p*	183.5	184.0	155.9	#	+ 17
Consumers' prices†	1935-39 = 100	185.4	184.6	184.5	169.3	#	+ 10
Personal income* (annual rate)	billions of $	—	244.4*p*	242.8	214.5	+ 1	+ 14
Composite index of wages and salaries*	1939 = 100	—	223*p*	221	206	+ 1	+ 8
Nonagricultural employment*	thousands	46,348*p*	46,387	46,274*r*	43,578	#	+ 6
Manufacturing employment*	thousands	16,034*p*	16,089	16,068*r*	14,629	#	+ 10
Average hours worked per week, manufacturing†	hours	40.6*p*	41.0	41.1*r*	39.9	− 1	+ 2
Unemployment	thousands	1,609	1,744	2,147	3,057	− 8	− 47
Banking and finance							
Total investments of all commercial banks	millions of $	70,600*p*	71,040*p*	71,320*p*	77,080	− 1	− 8
Total loans of all commercial banks	millions of $	54,460*p*	54,350*p*	54,420*p*	44,080	#	+ 24
Total demand deposits adjusted	millions of $	89,500*p*	89,500*p*	89,000*p*	85,000	#	+ 5
Currency outside the Treasury and Federal Reserve Banks*	millions of $	27,516	27,398	27,253	27,212	#	+ 1
Bank debits* (U. S. outside New York City)	billions of $	88.2	85.4	87.0	73.0	+ 3	+ 21
Velocity of demand deposits* (U. S. outside New York City)	1935-39 = 100	102.8	105.1	103.3	92.5	− 2	+ 11
Consumer instalment credit outstanding†	millions of $	—	12,906*p*	12,975	11,667	− 1	+ 11
United States Government finance (other than borrowing)							
Cash income	millions of $	4,152*p*	2,960	8,489	2,939	+40	+ 41
Cash outgo	millions of $	5,162*p*	4,144	4,219	3,700	+25	+ 40
National defense expenditures	millions of $	2,679*p*	2,386	2,238	1,095	+12	+145
SECOND FEDERAL RESERVE DISTRICT							
Electric power output*‡ (New York and New Jersey)	1935-39 = 100	229	227	225	206	+ 1	+ 11
Residential construction contracts*	1923-25 = 100	—	181	188	186	− 4	#
Nonresidential construction contracts*	1923-25 = 100	—	215	213	214	+ 1	− 8
Consumers' prices† (New York City)	1935-39 = 100	181.4	180.6	180.4	166.1	#	+ 9
Nonagricultural employment*	thousands	—	7,319.6*p*	7,329.0	6,977.7	#	+ 5
Manufacturing employment*	thousands	2,656.3*p*	2,670.9	2,657.9*r*	2,461.0	− 1	+ 8
Bank debits* (New York City)	billions of $	46.3	46.4	49.7	42.3	#	+ 9
Bank debits* (Second District excluding N. Y. C. and Albany)	billions of $	4.0	3.7	3.8	3.3	+ 6	+ 20
Velocity of demand deposits* (New York City)	1935-39 = 100	111.6	119.9	126.7	110.5*r*	− 7	+ 1

p Preliminary. *r* Revised. ‡ Corrected 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.

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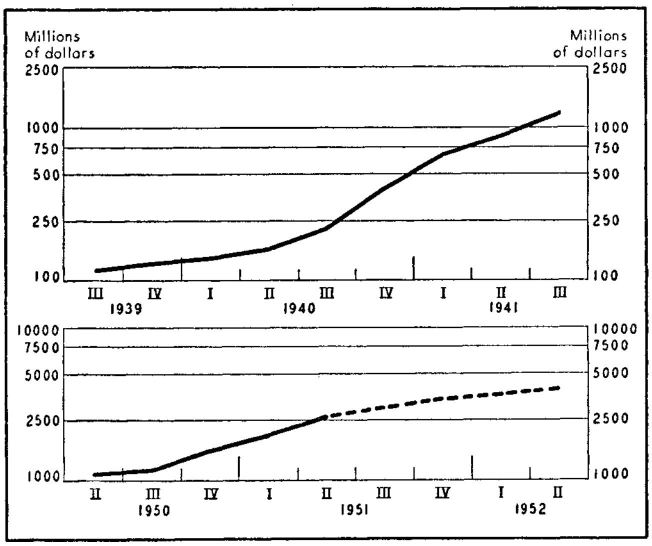
Comparison of National Defense Expenditures*
Quarterly averages of monthly outlays
July 1939-September 1941 and April 1950-June 1952†



* Plotted on ratio scale to show proportionate changes.
† Figures for fourth quarter 1951 and second quarter 1952 are estimates based on latest official Budget data.
Source: Compiled by the Federal Reserve Bank of New York from basic data of the War Production Board and the U. S. Treasury Department.

their own funds or by borrowing, and payments are made by the Government only after the contracts and orders are completed; while, in still other cases, a combination of these financing methods is employed. Under any of these arrangements, however, a lag of some proportion will be experienced between contract awards and actual payment, so long as contracts continue to increase in total volume.

During the current rearmament period, the rate of increase in war expenditures will probably be somewhat slower than that experienced in the initial phase of defense mobilization after Pearl Harbor. The relative slowness in acceleration of the present effort reflects both initial uncertainty as to the scope and characteristics of the program and the higher state of military preparedness from which the current expansion has begun.

Before the outbreak of the Korean conflict, defense disbursements were running at an annual rate of 13 billion dollars and absorbing less than 5 per cent of the gross national product. After a slow start, defense expenditures began to pick up, and by June of this year expenditures were about 2½ times the pre-Korean level. Official expectations (as reflected in the Budget and subsequent requests to Congress) are that early next year they will be close to 50 billion dollars (annual rate), or nearly four times as large as in June 1950. Some further increase, to an annual level of possibly 55 billion dollars, may occur before the middle of 1952. It is also apparently expected that expenditures will be maintained at this high level into 1953.

When the program reaches its peak, the defense and related outlays included in this bank's "current series" are expected to account for roughly 17 per cent of the national output of goods and services, or more than three times the proportion devoted to defense before Korea. The total program, including such other activities as economic aid to foreign countries, defense housing, and civilian defense (which cannot be segregated at this time) are expected, under present plans, to absorb roughly 18 per cent of gross output. While this is substantially less than the 41 per cent of total output which went to military and all other security purposes at the peak of World War II, the proposed scale nevertheless involves a considerable strain for the economy, at least until a growth in real output can overtake the increased physical volume of defense requirements.

DEPARTMENT STORE TRADE

After several weeks of comparative quiet following Easter, with sales generally ahead of year-ago levels by less than the corresponding percentage increase in consumers' prices, retail activity at New York City department stores was sharply accelerated late in May by a price "war" involving many fair-traded (price-fixed) items. Customers were quick to respond, flocking to the warring stores in numbers characteristic of a pre-Christmas buying rush. As a result, the dollar volume of department store sales in New York City during the week ended June 2 spurted 21 per cent ahead of the comparable weekly total in 1950. This was followed by year-to-year increases of 19, 15, and 14 per cent during the weeks ended June 9, 16, and 23, respectively. (It is estimated, that for the month of June department store sales in New York City were up 14 per cent from the June 1950 level, while the gain for the rest of the Second District amounted to about 7 per cent.)

As the chart shows, one of the most striking effects of the price war was the contraseasonal rise in sales volume during the week ended June 2. Normally, there is a sharp decline in volume during the week in which Memorial Day occurs, as there is one less day on which the stores are open for business. During the later weeks in June, as sales renewed their usual seasonal pattern, the volume maintained was well above year-ago levels not only because of activity in the lines directly affected by the price reductions but also because there was a carryover of consumer interest to other types of merchandise. The significance of the marked increase in demand generated by the price war is brought into sharp focus by comparing the week-to-week increase in dollar volume from June 2 to June 9 with the corresponding week-to-week movement in 1950. Department store sales during the week ended June 9 were 27 per cent above those of the preceding week, while the comparable increase in 1950 amounted to 31 per cent. Thus, the percentage gain in sales from the week ended June 2 to that ended June 9 this year almost equaled that of the comparable period a year ago, despite the much higher level from which the rise this year began.

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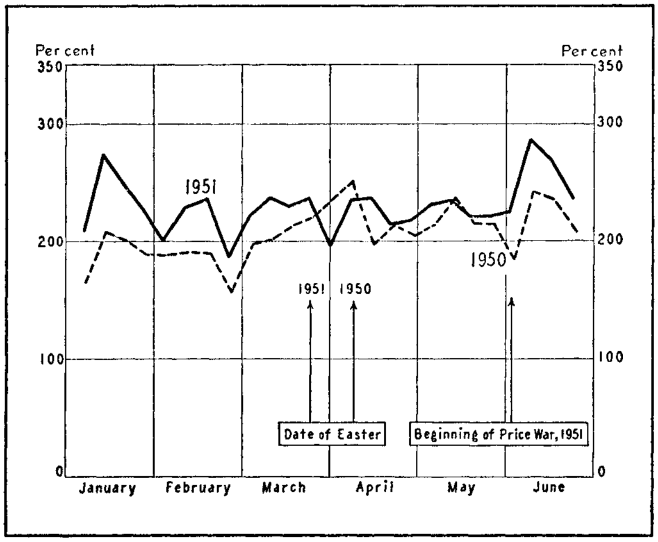
Weekly Indexes of New York City Department Store Sales, January-June 1950 and 1951*
(Without adjustment for seasonal variation, 1935-39 average=100 per cent)



* Indexes are totals for calendar weeks without adjustment for variations in the number of shopping days. Figure for week ended June 23, 1951 is preliminary.

As already noted, the fair-traded merchandise that was drastically reduced in price did not by any means represent the sole object of consumer interest. Demand for major household durables, for example, was particularly outstanding. As a matter of fact, sales of furniture and bedding, rugs and carpets, and major appliances during the week ended June 2 were up 33, 71, and 104 per cent, respectively, from their corresponding year-ago levels. Moreover, the rapid turnover of these goods was not confined to the first week of the price war but rather continued throughout the rest of the month. Demand for radio-television, however, did not show any appreciable increase until the weeks ended June 9 and 16 when year-to-year gains in sales of 31 and 78 per cent, respectively, were registered.

Just as the resurgence of consumer demand during June was not limited to price-war merchandise, substantial year-to-year increases in total sales were not restricted to those stores most actively engaged in the price war. As a matter of fact, many of the other New York City department stores reporting weekly to this bank have shown sizable gains in sales volume in recent weeks. (The number of non-warring stores recording increases, however, has diminished somewhat since the week ended June 2.) The sharp increase in consumer traffic attributable, in large measure, to the price war also apparently bolstered sales in several New York City apparel stores, although these stores stock few of the merchandise lines affected by the fair-trade controversy and did not initiate substantial price reductions (as far as can be determined) in their other lines. Unlike the situation with regard to the "neutral" department stores, however, substantial year-to-year advances in sales volume were generally limited to those apparel stores located in the immediate vicinity of the warring department stores and, in most cases, those advances did not continue after the first week of the price war.

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

Item	1951 May	1951 April	1951 March	1950 May
Sales (average daily), unadjusted	238	232	230	224r
Sales (average daily), seasonally adjusted	243	252	230	228r
Stocks, unadjusted	294	306	306	232r
Stocks, seasonally adjusted	290	297	299	229r

r Revised.

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

Locality	Net sales: May 1951	Net sales: Jan. through May 1951	Stocks on hand May 31, 1951
Department stores, Second District	+ 7	+13	+27
New York City	+ 4	+12	+29
Northern New Jersey	+ 9	+15	+28
Newark	+ 7	+14	+29
Westchester County	+24	+17	+20
Fairfield County	+17	+15	+23
Bridgeport	+19	+16	+24
Lower Hudson River Valley	− 1	+ 6	+21
Poughkeepsie	+ 2	+ 8	+23
Upper Hudson River Valley	+15	+16	+14
Albany	+11	+19	+17
Schenectady	+20	+13	+12
Central New York State	+ 4	+12	+30
Mohawk River Valley	+ 3	+10	+24
Utica	+ 2	+ 7	+24
Syracuse	+ 4	+13	+34
Northern New York State	+ 9	+ 8	+17
Southern New York State	+ 4	+14	+19
Binghamton	+ 3	+12	+16
Elmira	− 6	+20	+28
Western New York State	+11	+13	+28
Buffalo	+12	+13	+29
Niagara Falls	+ 5	+10	+28
Rochester	+12	+13	+25
Apparel stores (chiefly New York City)	+ 1	+ 7	+21

THE TREASURY'S CASH BALANCES

In the past month, the Treasury again made use of a technique that had first been introduced in March of this year to soften the impact of quarterly tax collections on the reserve positions of the banks. When tax checks drawn on the commercial banks are deposited in the Treasury's accounts in the Reserve Banks, there is, of course, an equivalent drain on member bank reserves, because the Reserve Banks collect the checks by deducting the amounts from the member banks' reserve balances. Therefore, heavy concentrations of tax payments can result temporarily in severe and sudden tightness in the money market, as banks attempt to obtain funds in that market to replenish their reserves. This tight condition in the money market would normally ease only gradually, as the Treasury spent tax receipts over a period of time. In an effort to reduce this temporary and more or less mechanical tightening of bank reserve positions, the Treasury is permitting the banks to carry as Treasury deposits on their own books amounts equivalent to the checks (of 10,000

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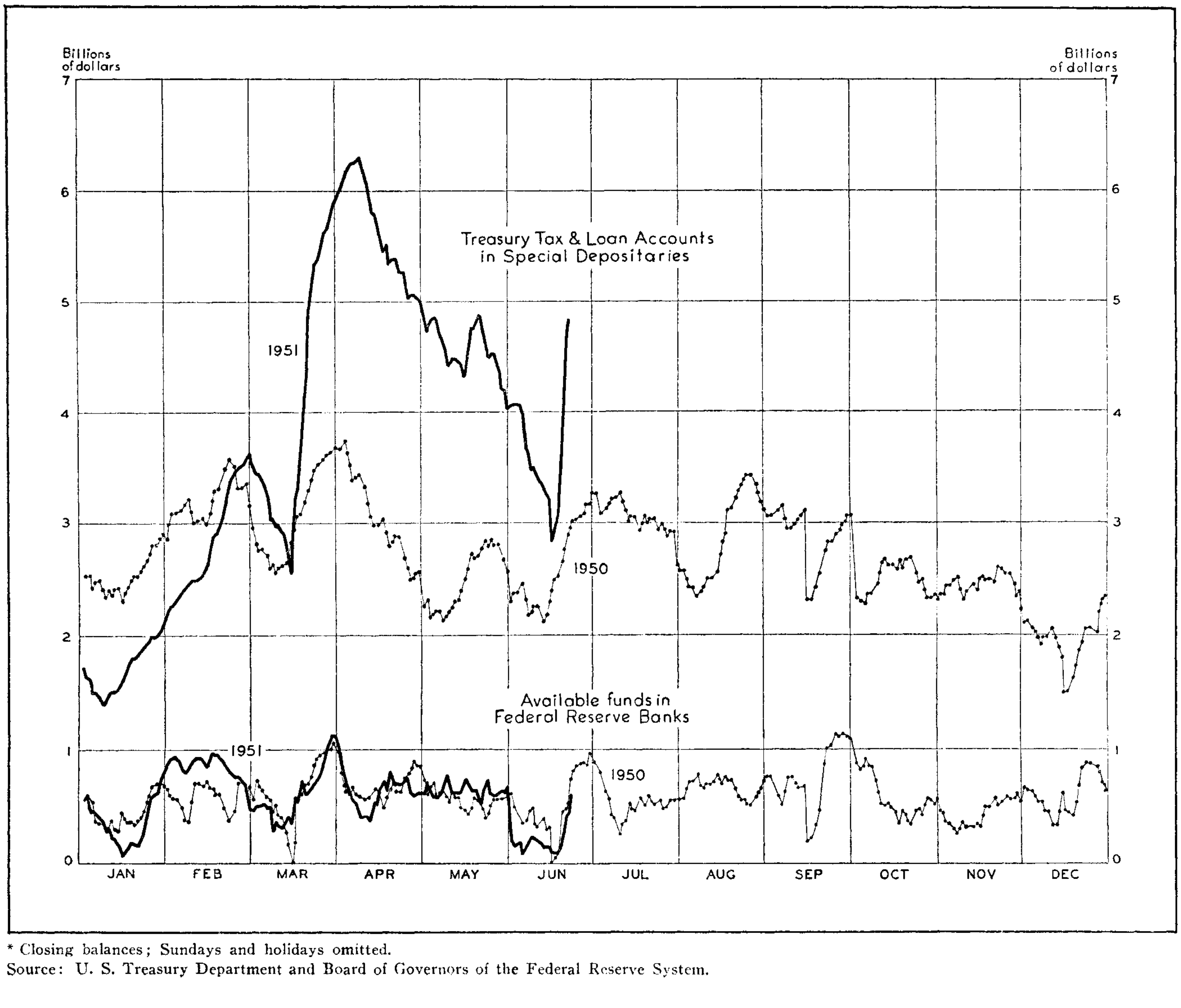
dollars or more) which have been drawn upon them for payment of income and profits taxes, after these checks have been deposited by tax collectors for the Treasury's account in the Federal Reserve Banks. The credits arising in "Treasury Tax and Loan Accounts" from these tax payments have been specially designated as "X" balances. The funds thus built up in Treasury accounts at the commercial banks are being withdrawn as they are needed by the Government; they will be depleted (or any small residual amounts will be transferred to the regular accounts) before calls are made on the other credits in Tax and Loan Accounts.

The "X" balance procedure was first used in March to cover the record tax payments by corporations, but last month it was extended to include individual income tax checks of 10,000 dollars and over. The extension will not add appreciably to the amount of credits to the "X" accounts since relatively few individuals have a yearly tax liability over 40,000 dollars. The change will, however, tend to equalize the benefits of the new procedure between the banks.

If all of the quarterly tax collections had been allowed to flow directly into the Reserve Banks in the usual fashion, the banks would have faced an extremely difficult task in maintaining their reserve positions. This year, record payments of corporate taxes were made as a result of unparalleled profits, higher tax rates on ordinary income, the enactment of an excess profits tax law, and the introduction of the Mills Plan for accelerating the payment of corporate taxes. Moreover, the banks could no longer rely upon as ready a market as in former years for the Government securities which they might have had to sell to cover the losses of reserves entailed in paying tax funds into the Treasury's deposits at the Federal Reserve Banks.

Under the Mills Plan, corporate tax collections are being gradually brought forward, so that eventually all corporate taxes will be paid within six months after the end of the year in which the tax liability is incurred. Formerly, corporations paid their taxes in approximately equal instalments in the four quarterly periods following the end of their tax year (which

Treasury Deposits in Federal Reserve Banks and Special Depositaries, January 1950-June 22, 1951*



* Closing balances; Sundays and holidays omitted.
Source: U. S. Treasury Department and Board of Governors of the Federal Reserve System.

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for most corporations is December 31). In 1951, however, 30 per cent of the tax liability of most corporations for 1950 income had to be paid in the first quarter; an additional 30 per cent was due in the second quarter; and 20 per cent is to be paid on each of the two remaining quarterly "tax dates". By 1955 half of a corporation's tax liability will be due in the third month after the close of its fiscal year, and the remaining half before the end of the following quarter.

The adoption of the "X" balance device for the March and June income and profits tax payments represents another step in the Treasury's continuing effort to prevent seasonal or other fluctuations in Treasury cash receipts or disbursements from exerting an unduly abrupt or extreme influence upon bank reserves and the money market. Some of the other special procedures previously developed by the Treasury have been discussed in past issues of this *Review.*[1] This article brings together the principal changes in procedure over the past several years in order to present a brief description of the present characteristics of the Treasury's cash operations.

Types of Depositaries

Like that of any business, the working cash of the Treasury consists of bank accounts and currency, but unlike private concerns, the Treasury's active cash is held mainly in deposit accounts maintained at each of the Federal Reserve Banks and their branches. Large balances are, of course, built up in the Treasury Tax and Loan Accounts maintained at "Special Depositaries" (qualified commercial banks and other banking institutions), but these balances are not drawn upon directly for Treasury disbursements. They are instead transferred into the Treasury accounts at the Reserve Banks through "calls" of varying amounts from time to time. Government disbursements to the public for the most part are made through checks paid from the balances held in the Federal Reserve Banks. Daily average balances at the Reserve Banks in recent years have ranged from around 1.4 billion dollars in 1948 to an average of about 600 million in the first six months of 1951. The amount on deposit in the Tax and Loan Accounts, on the other hand, increased from an average of nearly 1.8 billion dollars in 1948 to 3.8 billion in the first half of 1951. The rise in the latter accounts reflected not only the rise in the Treasury's cash receipts in this period but also the Treasury's increasing use of the Tax and Loan Account technique, since March 1948, as a means of spacing out the impact of its large cash receipts on the reserves of the banking system.

Relatively small amounts (around 300 million dollars) of the Treasury's funds are also held in insured domestic banks designated as "General Depositaries", and in insular, territorial, and foreign depositaries. Accounts are maintained in these various types of depositaries, in areas at some distance from Federal Reserve Banks or their branches, to provide agents of the Federal Government with convenient facilities for depositing funds collected and to permit disbursing officers to make payments in local funds. In many cases General Depositaries qualify as Special Depositaries as well. The Treasury also maintains a "Cash Room" in Washington where currency may be obtained or Treasury checks cashed, but the flow of funds through the Cash Room is relatively insignificant.

In addition to these bank accounts and cash balances, the Treasury has an additional large cash asset referred to as "free gold" (excess of gold bullion over specific gold liabilities) and some "free" silver bullion, which for the most part could be used to cover general operations. These are not properly included, however, in a description of the routine banking of the Treasury's funds.

Funds in the Special Depositaries

"Treasury Tax and Loan Accounts" (formerly known as "War Loan Deposit Accounts") are maintained at nearly 11,000 designated banking institutions in the continental United States. By allowing funds to accumulate in the Tax and Loan Accounts and withdrawing them through calls only as desired, the Treasury can achieve a measure of control over the flow of cash into its accounts at the Federal Reserve Banks, and the potential disturbance to the money market and to bank reserves can be held to a minimum. The reserves which banks lose through calls can be immediately or very shortly returned through Government disbursements, if calls are planned to coincide closely with out-payments, whereas if all Treasury receipts were deposited immediately at the Reserve Banks, reserves would frequently be drained off long before the Treasury could be in a position to disburse them. Although the Tax and Loan deposits are payable on demand, the Treasury gives several days' notice by calling for the funds before payments are due.

In order to permit some differentiation between larger and smaller deposit accounts, the Treasury has classified its Special Depositaries into two groups. The present classification places banks whose Treasury Tax and Loan Account balances on December 20, 1950 were 100,000 dollars or less in group A; those with larger balances on that date, in group B. (This classification does not apply to the "X" balances, however.) The Treasury may also call for funds from individual banks without regard to any classification, but this has not often been done. Individual calls were made early in the past month, but these withdrawals were confined to those banks which benefited more than the Treasury thought desirable from the switching out of the old Savings notes into the new series by their depositors.

Until 1948, funds flowed into the Special Depositary accounts only as a result of Treasury borrowing operations. But early in that year the Treasury decided to permit withheld income taxes to be credited to its accounts in the depositary banks. At the beginning of 1950, the same arrangement was extended to payroll taxes under the old-age insurance program; and as already noted, the large quarterly corporation tax payments (checks of 10,000 dollars or more) were handled

[1] See "U. S. Treasury Tax and Loan Accounts at Banks", published by this bank in a collection of articles entitled, *Bank Reserves—Some Major Factors Affecting Them,* March 1951, and "Direct Security Purchases from the Treasury by the Federal Reserve Banks", *Monthly Review,* August 1950.

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similarly in March of this year, with the quarterly payments of large nonwithheld individual income tax checks (10,000 dollars or more) being treated in this way for the first time in June. Beginning July 1, taxes on carriers under the Railroad Retirement Act have become eligible for payment into the Tax and Loan Accounts. If the "X" balance technique should be applied to the remaining quarterly tax payments this year, roughly three fifths of the Treasury's receipts (including cash borrowing) from the public will have been creditable initially to the Treasury Tax and Loan Accounts. In 1947, when only the proceeds of sales of Savings bonds and notes were payable into the War Loan Deposit Accounts (as they were then called), the maximum flow of funds into the Special Depositaries could not have been greater than 17 per cent of aggregate Federal cash receipts.

Not all of the creditable receipts pass through accounts held with the Special Depositaries, but a large share of them do. In 1950, about two thirds of the receipts from Savings bonds, withheld income taxes, and old-age taxes were credited to these accounts, and practically all of the proceeds of Savings notes went into Tax and Loan Accounts. About 85 per cent of all corporate income and excess profits taxes collected in March 1951 flowed into the Special Depositaries. Only a small portion of the individual income tax checks in June were large enough (10,000 dollars) to be paid by crediting the Treasury Tax and Loan Accounts, but it is estimated that they added around 150 million dollars to the flow of funds into these accounts.

The flow of funds into the Special Depositaries from the several eligible sources has until recently been fairly stable, averaging around 1.4 billion dollars in most months in 1950. Receipts from the sales of Savings bonds, except for the special sales, have been highest in the first three months of the year and in July and December, whereas receipts of withheld taxes are customarily low in the first month of each quarter, high on the second month, and moderate in the third as a result of technical characteristics of the payment schedule. The major changes in sales of Savings notes during the postwar period have apparently paralleled the changes in market rates of interest; but sales have also tended to rise in the quarterly months when corporation taxes were paid (and notes redeemed), as corporations then purchased new issues to cover later tax payments. This year, of course, large receipts from the quarterly income and excess profits taxes were received in March and June. If the Treasury continues to permit quarterly payments of these taxes to flow into the Tax and Loan Accounts, receipts at the Special Depositaries will no doubt show sharp quarterly peaks in the future.

Deposits at the Federal Reserve Banks

The Treasury's accounts at the Federal Reserve Banks have fluctuated basically with the Treasury's needs, reflecting the Government's cash income and outgo (both operating and debt transactions). But the precise level, above the operational minimum, has normally been determined with reference to the influence on the money market of a shift of funds into (or out of) the Federal Reserve Banks. The minimum level must be adequate for expected daily cash needs, and must also provide for the appropriate distribution of the funds for operating convenience among the 12 Federal Reserve Banks and their 24 branches. When the aggregate volume of receipts and expenditures is increasing, larger errors may be made in estimating the daily needs, and consequently a somewhat higher minimum level is necessary.

The influence of the Treasury's cash receipts and payments upon the money market can be most nearly neutralized by maintaining the volume of deposits at the Reserve Banks relatively constant. To soften the impact on member bank reserves of unusually large receipts, however, the Treasury may let this balance run off in advance and temporarily borrow directly from the Reserve Banks rather than call for funds from the Special Depositaries. This has been done on several occasions in recent years to cover quarterly interest payments, which to a large extent immediately precede the collection of quarterly income and profits tax checks.

At times, the Treasury may exert a strong influence on the money market by changing the level of its deposits at the Reserve Banks. In 1948, for example, on the basis of consultation with the Federal Reserve System, these deposits were increased and maintained during the last half of the year at an average level of about 1.6 billion dollars at a time when the System was striving to restrain expansionary tendencies in bank credit. Conversely in 1949, Treasury deposits at the Reserve Banks were allowed to decline, and in the second half of the year averaged less than 600 million dollars.

In order to schedule its calls to take account both of its daily needs and of the effect of its operations on money market conditions, the Treasury must have short-term estimates of its cash receipts and Government disbursements and their net effect on its balance in the Reserve Banks. Similiarly, it must estimate the inflow of funds to its accounts at the Special Depositaries. These estimates require detailed study of Treasury receipts from regular operations, the probable proceeds of Treasury borrowing operations, the time pattern of Government disbursements, and the drain arising from cash redemptions of outstanding Treasury debt. Estimates must distinguish, of course, between factors initially affecting Treasury balances at the Reserve Banks, and those representing accumulations (subject to later call) at the Special Depositaries. These estimates are prepared continuously by the Treasury and Federal Reserve staffs, on a daily, weekly, monthly, and quarterly basis.

Because of the wide range of influences at work — the varying tax dates, changing levels of taxable incomes, seasonal and cyclical influences on outlays, changes in the schedule of callable and maturing debt, as well as changes in Government programs — it is not a simple problem to manage the Treasury's balances. The special collection arrangements adopted this year, in conjunction with similar measures taken since March 1948 to expand the use of the Special Depositary technique, will materially lessen the severity of the impact upon the money market of fluctuations in the Treasury's cash position.

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NATIONAL SUMMARY OF BUSINESS CONDITIONS

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

Industrial production was maintained at earlier advanced levels in May and the first three weeks of June. In wholesale markets basic commodity prices declined further, while prices of finished commodities generally changed little. Consumers' prices in May advanced to a new high. Awards for defense construction rose sharply. Retail sales were maintained, following earlier declines. Up to early June bank loans to business declined somewhat, but subsequently a sharp rise occurred; defense loans have been increasing significantly.

Industrial Production

The Board's seasonally adjusted production index in May was maintained at the March-April level of 223 per cent of the 1935-39 average. In June, industrial production is expected to continue at about this rate, which is 12 per cent higher than a year ago.

Activity in durable goods industries has been stable since March, with industrial and military equipment expanding further, consumer goods declining, and most metals and building materials showing little change. Steel mill activity in May and June has continued at earlier record levels, and ingot output of about 52.5 million tons in the first half of this year has exceeded that in the first half of 1950 by 11 per cent. Passenger car assembly in May and June has been maintained close to the April rate of 500,000 cars per month, while output of most household durable goods has apparently declined considerably further.

Output of nondurable goods in May remained at the high April level. A slight gain for textiles reflected mainly termination of a labor dispute at cotton mills. Paperboard production reached a new record rate in May, but subsequently declined slightly. Chemicals production continued to expand. Meat production declined somewhat in May; in the first half of June, pork production increased while beef output dropped sharply.

A further small gain in minerals output in May reflected mainly near-record volume of iron ore production for this season. In May and early June crude petroleum production was maintained at record levels and coal output continued at a reduced rate.

Employment

Employment in nonagricultural establishments in May, after allowances for seasonal influences, continued at the record April level. The average factory work week declined slightly, while average hourly earnings continued to rise. Unemployment declined somewhat further to 1.6 million, the lowest level since October 1945.

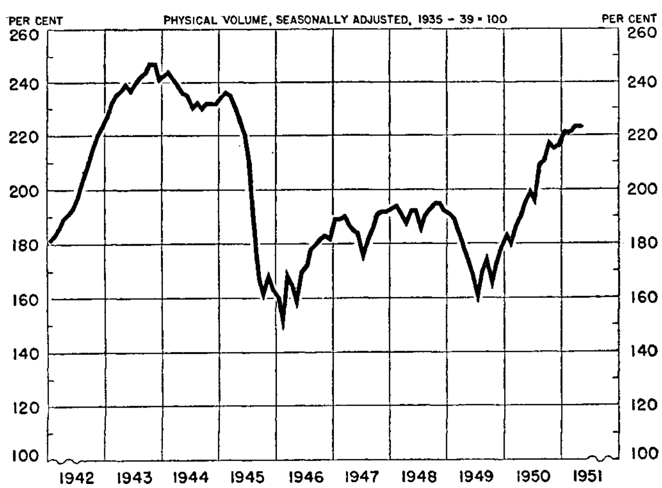
Construction

Value of construction contract awards showed an unprecedented increase in May, reflecting primarily issuance of several large awards by the Atomic Energy Commission totaling almost one billion dollars. Awards for some other types of nonresidential construction also showed more than the usual seasonal rise. Nonfarm housing starts increased to 97,000 in May; this was more than one-third below the same month a year ago but about the same as in May 1949.

Distribution

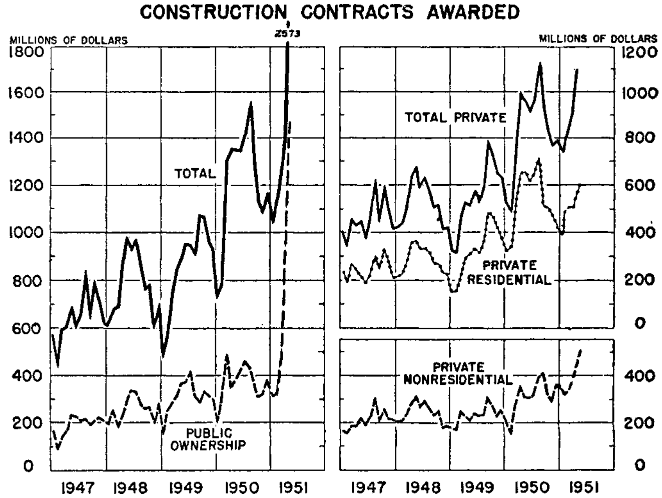
Value of retail sales, seasonally adjusted, was maintained in May, following a considerable decline from January to April. Sales of household durable goods decreased further, while sales of apparel and other soft goods increased somewhat. Sales by automotive dealers showed little change. In the first three weeks of June sales at department stores continued at about the May level; in New York City sales rose considerably in response to a "price war". Seasonally adjusted value of department store stocks at the end of May was about 30 per cent above year-ago levels, roughly the same as at the end of April.

INDUSTRIAL PRODUCTION



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

CONSTRUCTION CONTRACTS AWARDED



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

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Commodity Prices

The general level of wholesale commodity prices has continued to change little since mid-May. Prices of such basic commodities as grains, fats and oils, cotton gray goods, wool, and tin have declined further, and a 14 cent reduction in the price of rubber, to 52 cents per pound, has been announced effective July 1. Prices of finished goods generally have been maintained. Several manufacturers of carpets have reduced prices up to 11 per cent, less than the increases effected in April when ceilings were raised. Prices of hard floor coverings, in contrast, have been raised further.

Consumer prices rose 0.4 per cent in May. Prices of foods, which had declined slightly in April, rose 0.8 per cent to a new high.

Bank Credit and the Money Supply

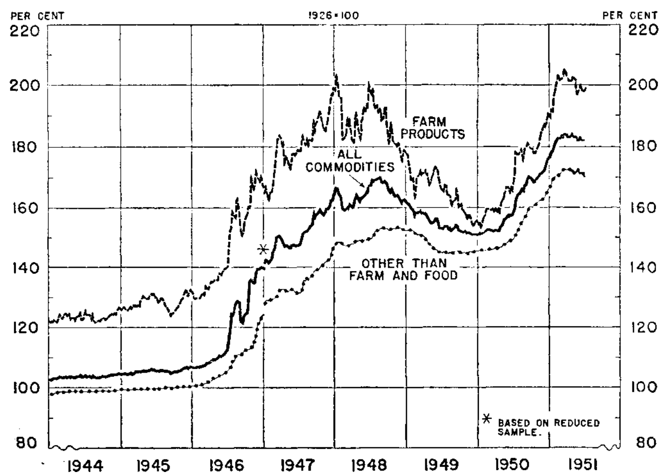
Business loans outstanding at banks in leading cities declined somewhat between mid-May and early June and rose thereafter. Loans to finance defense contracts and "defense supporting" activities, principally to metal manufacturers and public utilities, increased considerably. Seasonal decreases continued in some types of loans, particularly those to commodity dealers and processors of agricultural commodities.

Deposits and currency held by businesses and individuals increased somewhat in the first half of June following relatively little change in May. The rate of use of demand deposits at banks in leading cities outside New York remained high in May, but was slightly below that of April, the seasonally adjusted peak for recent years.

Money Rates and Security Markets

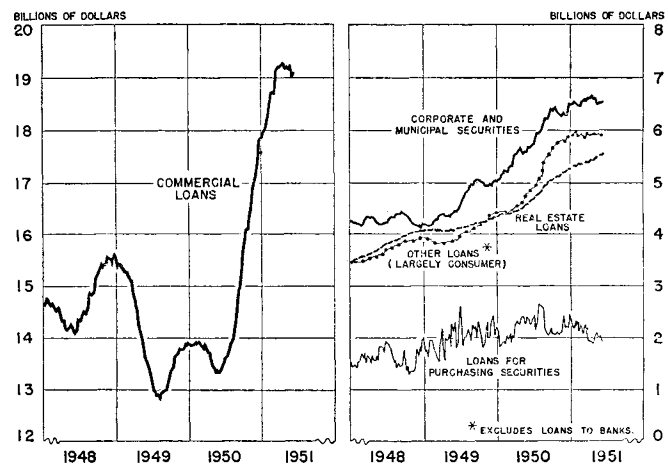
Common stock prices showed a moderate advance in early June but by the end of the third week had declined to a level slightly below that of May 31. Yields on high-grade corporate bonds increased moderately during the first three weeks of June. With easy money conditions prevailing, yields on Treasury bills and other short-term Government securities declined somewhat. On May 28 the Secretary of the Treasury announced the offering of a 9½ month 1⅞ per cent certificate of indebtedness to holders of the 2¾ per cent bonds previously called for redemption on June 15, and the 1¼ per cent Treasury notes maturing on July 1. Of the 10.1 billion dollars of maturing securities, about 9.5 billion were exchanged for the new certificates.

WHOLESALE COMMODITY PRICES



Bureau of Labor Statistics' indexes. Weekly figures; latest shown are for week ended June 19.

LOANS AND INVESTMENTS AT MEMBER BANKS IN LEADING CITIES
OTHER THAN U. S. GOVERNMENT SECURITIES



Commercial loans include commercial, industrial, and agricultural loans. Wednesday figures; latest shown are for June 13.

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