

MONTHLY REVIEW

Of Credit and Business Conditions

FEDERAL RESERVE BANK OF NEW YORK

VOLUME 34

MARCH 1952

No. 3

MONEY MARKET IN FEBRUARY

Money market conditions during most of February were firmer than in January, reflecting some pressure on bank reserves resulting in part from an increase of Treasury balances in the Reserve Banks to more normal levels. In addition, net sales of short-term Government securities were made by the Federal Open Market Account to meet the continuing demand for such securities and to absorb additional reserves arising out of a substantial net increase in Federal Reserve float over the first three weeks of the month and continued net foreign disbursements. In the latter part of the month, however, the System purchased substantial amounts of securities to facilitate the very large Treasury refunding operations announced on February 13 and did not fully offset its purchases by sales of other securities at the time. The rate on Federal funds in New York remained close to the discount rate during the first three weeks of February, but eased moderately thereafter. Reserve positions of the commercial banks in the rest of the country were generally tight throughout the month.

The Treasury refunding operations, which were announced on February 13, included the offering of a new $2\frac{3}{8}$ per cent, 5-7 year bond in exchange for the $2\frac{1}{2}$ per cent bond called for redemption on March 15, outstanding in the amount of approximately 1 billion dollars, and the offering of a new $1\frac{1}{8}$ per cent, 11½-month certificate of indebtedness in exchange for the 9.5 billion dollars of certificates maturing on April 1. The subscription books were open from February 18 to 21, inclusive, and both types of new securities were to be issued on March 1 with adjustment of interest to maturity or redemption dates.

Market opinion indicated general approval of the terms chosen for these Treasury offerings, with particularly favorable comment concerning the Treasury's decision to make its first offering of a marketable bond since the issuance of the Victory bond in December 1945. Considerable shifting of ownership of the called bonds and maturing certificates occurred in advance of the exchange, however. Many of these securities were held as short-term investments by corporations

and other investors who shifted into Treasury bills and certificates of short maturity. Demand in the market for the "rights" to the new issues, especially the 5-7 year bonds, was limited, probably reflecting in part the imminence of the March 15 tax date and uncertainty concerning the market conditions that may prevail during March as a consequence. In these circumstances, the Federal Reserve System made fairly substantial purchases of the called and maturing securities, but offset a considerable part of its purchases by sales of short-term securities.

Despite the relative scarcity of bank funds for security investment, the short-term security market continued the firmness that had characterized it in January, as corporation funds seeking investment pressed on available supplies of short-term securities. The other sectors of the Government security market were fairly steady on a limited volume of trading. Bank business lending, which had declined significantly over the five statement weeks in January, showed a tendency to level off during February, as expanded defense borrowing offset a continuing decline in nondefense credit.

MEMBER BANK RESERVES

The net effect of the several factors influencing member bank reserve balances and excess reserves, shown in the table, was to maintain moderate pressure on reserve positions during nearly all of February. Excess reserves available to the banking system were never above what have come to be considered

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**Weekly Changes in Factors Tending to Increase or Decrease
Member Bank Reserves, February 1952**
(In millions of dollars; (+) denotes increase,
(—) decrease in excess reserves)

Factor	Statement weeks ended				Four weeks ended Feb. 27
	Feb. 6	Feb. 13	Feb. 20	Feb. 27	
<i>Operating factors</i>					
Treasury operations*	+155	-168	-258	-220	-491
Federal Reserve float	+47	-124	+399	-261	+61
Currency in circulation	-31	-47	+38	-3	-43
Gold and foreign account	+54	+55	+12	-8	+113
Other deposits, etc.	+7	+9	-13	+69	+72
Total	+234	-276	+177	-420	-285
<i>Direct Federal Reserve credit</i>					
Government securities	-171	-115	-99	+155	-230
Discounts and advances	+72	+337	-165	-32	+212
Total	-99	+222	-264	+123	-18
Total reserves	+135	-54	-87	-297	-303
Effect of change in required reserves	+24	+130	+5	+59	+218
Excess reserves	+159	+76	-82	-238	-85

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

"normal" working levels, and on several days rather substantial borrowing from the Federal Reserve Banks was necessary by banks adjusting their reserve balances to their requirements.

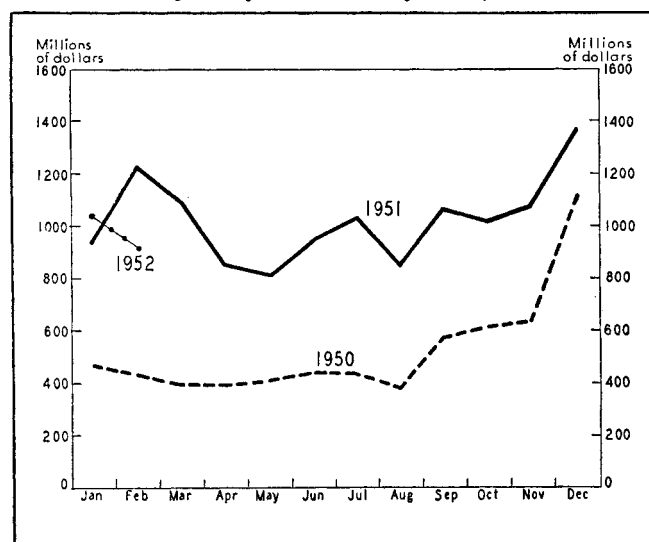
Moderate pressure on bank reserves was apparent in the New York money market as the rate on Federal funds, which had been below 1 per cent during most of January, rose above 1½ per cent early in February and then fluctuated at levels just below the 1¾ per cent Federal Reserve discount rate until the latter part of the month. Part of the demand for Federal funds originated with out-of-town banks, but the consistently low levels of New York City bank excess reserves would indicate that the most important demand came from New York banks. The sources of gains and losses of funds to the money market followed the customary pattern. Funds gained from Treasury expenditures in excess of funds acquired by the Treasury in New York City, plus funds gained through foreign account disbursements, were largely offset by the outflow of funds to other parts of the country. Sales of securities by the Federal Open Market Account constituted another important drain on City bank funds in February.

For the country as a whole, the factors exerting the greatest influence on member bank reserve positions were Treasury operations, changes in Federal Reserve float, and Federal Reserve security and lending operations. In each of the last three statement weeks in February, unusually large Treasury tax receipts, reflecting in part lagging tax collections in previous months, together with Treasury withdrawals from its Tax and Loan Accounts in the banks, enabled the Treasury to build up its deposit balances with the Federal Reserve Banks, draining reserves from the member banks. Float followed the customary monthly pattern, increasing as a result of expanded check usage toward the middle of the month and then tapering off in the last statement week.

Steady selling by the System to maintain some pressure on bank reserves was made possible by the strong nonbank demand for short-term investments. Net sales by the System totaled 385 million dollars during the first three statement weeks of February, and by February 20 Government security holdings in the System Open Market Account were at the lowest level since last May. Despite substantial market purchases made for Federal Reserve account in connection with the Treasury's refunding offer, the System was able to take 230 million dollars out of the market through net security sales for the month as a whole. Federal Reserve discounts and advances, which are initiated by the borrowing banks, served their traditional function as a "shock absorber", expanding to offset losses of funds and contracting when reserves became available from other sources. During the four weeks ended February 27, they showed a net increase of more than 200 million dollars.

Since 1950, Federal Reserve float has been the most important week-to-week variable affecting bank reserves and, with the exception of net purchases of Government securities by the System, the most important source of net additions to bank reserves. The significance of this source of banking funds is shown in the accompanying chart. The average daily level of float in 1951, month by month, was some 500 million dollars greater than in the corresponding months of 1950. (There was a dip below last year's level, however, in February 1952 which may be explained by the unusually large float in February 1951 when the railroad strike and weather conditions delayed check shipments.) Float arises as a by-product of the service provided by the Federal Reserve System in collecting out-of-town checks for banks. The bank sending in a check for collection is credited for the check automatically (subject

Federal Reserve Float
(Monthly averages of daily figures,
January 1950-February 1952*)



* February 1952 estimated from data for first 27 days of the month.

to the check's being honored) after an arbitrary period of time specified by what is called the "availability schedule". Since this schedule frequently is less than the actual time necessary for the check to be collected, there are at all times large numbers of checks for which payee banks have received Reserve Bank credit but which have not yet been debited to the reserve accounts of the payor banks. Part of the explanation for the very marked expansion of float in 1951, and thus far in 1952, above earlier levels lies in the greater number and dollar volume of checks that has grown out of the expanded dollar volume of business activity. More important, however, was the action of the Federal Reserve System in January 1951 in lowering the maximum availability time from three days to two. This action gave commercial banks more rapid access to funds from checks being cleared, but it also increased the number of checks credited before collection and thus substantially contributed to member bank reserve balances.

TREASURY FINANCING AND THE GOVERNMENT SECURITY MARKET

Despite the general tightness of bank reserves, the market for short-term Government securities remained firm throughout February. The buying pressure was concentrated in the very short-term area, and represented in part investment by nonbank investors of funds being accumulated for tax payments in March. There also was buying interest in issues maturing near the June tax date, particularly the July 1 certificate of indebtedness. Average issue rates on new bills reflected the firm tone in the short-term market, and the issue dated February 21 was placed at an average discount of 1.507 per cent, down appreciably from the 1.589 per cent on the January 31 bills, and the lowest new bill rate with but one exception since last June. The bill issue dated February 28 increased somewhat in yield to an average of 1.563. The principal sources of supply of short-term securities were the System Open Market Account (in the case of certificates) and commercial banks, including some New York City banks. Corporate purchases of Savings notes intended for use in March tax payments were made in substantial volume in the first half of the month, as the low rates on comparable maturities of marketable securities encouraged shifts into this form of investment. A large part of the Savings note investment took place in the one-week period following the Treasury refunding announcement, as March and June tax funds were shifted out of the maturing issues.

Prices in the intermediate sector were generally steady through the month in an inactive market. Maturities in the 1957-59 range sold off slightly following the Treasury announcement of the terms of the March 1 refunding operation, but this loss was subsequently recovered and the intermediate issues closed the month on a steady tone. Prices of

long-term Treasury bonds in February failed to extend the recovery that had taken place in the last half of January, and tended to fluctuate in a limited range around the January closing levels. Rather sharp declines occurred in each of the first two statement weeks, as a result of professional activity, but recovery was rapid in each case and the market, while chronically thin, was relatively firm over most of the month. Some easing was apparent in the market toward the end of February, attributable in part to the large volume of corporate financing scheduled for March, but for the month as a whole only insignificant price changes were recorded.

The Treasury's announcement on February 13 of the offerings for its spring refunding schedule occasioned the greatest amount of market activity during the month. Rather aggressive selling of the March 15 and April 1 "rights" followed the Treasury announcement and continued until the subscription books closed on the 21st. During the four-day period when Treasury books were open, the Federal Reserve System acted to lend stability to the market by purchasing substantial amounts of the maturing issues. The greater part of these purchases, however, were offset during the same period by sales of near-maturity certificates from the System portfolio. Unexchanged securities, which will be redeemed by the Treasury, amounted to 10 per cent for the March 15 bonds and 7 per cent for the April 1 certificates.

Comment in the market suggested that the limited demand for the new Treasury issues was more the result of particular circumstances in the market than of any general dissatisfaction with the terms of the issues. Similar issues of $1\frac{7}{8}$ per cent certificates have been well received on the several occasions when they have been offered during the past year, and the

DEBITS AND CLEARINGS STATISTICS

The Board of Governors of the Federal Reserve System has recently published a technical paper entitled *The Development of Bank Debits and Clearings and Their Use in Economic Analysis*, by George Garvy, Senior Economist of the Research Department, Federal Reserve Bank of New York. In this paper, an attempt is made to combine a study of the clearings and debits series with a broad investigation of the contributions these series have made to economic analysis and of the services they have rendered to the economic analyst, historian, and theorist. This publication is available at a price of 25 cents for single copies, and at 15 cents per copy in quantities of 10 or more. All orders should be addressed to the Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington 25, D. C.

consensus of market opinion has been that the new 2¾ per cent bond was a well conceived offering. However, a good deal of March 15 tax money had been invested in the two issues, and this money was not available for exchange into the refunding issues. Investors holding the maturing securities for tax investment purposes had the alternative of redeeming them at maturity for cash or of selling the "rights" during the period of exchange. Since the premium on the "rights" was more than sufficient to cover reinvestment costs, many tax investors chose to sell, and it was this selling that occasioned the System purchases. Possibly of some importance, as well, in explaining the lack of buying interest in the "rights" to the new issues, was the fear (which may not prove to have been well founded) that general monetary tightness in the coming month may cause some easing in security prices. Thus, a substantial part of the available funds has been going into the very short area in anticipation of this development.

Also in February, the Treasury announced its decision not to call the 2¼ per cent bonds of June 15, 1952-55 and the 2 per cent bonds of June 15, 1952-54, as well as the 2 per cent bonds which had originally been issued for December 15, 1951-55 and which had already been passed by the Treasury on the first call date.

MEMBER BANK CREDIT

After declining by 432 million dollars over the five statement weeks ended in January, the business loans of the weekly reporting member banks in the larger cities tended to stabilize during the first three weeks in February. By February 20, commercial, industrial, and agricultural loans of the reporting banks were down only 12 million dollars from their January 30 level. Defense lending continued to increase in February, and offset continuing reductions in certain nondefense lines. Loans to food, liquor and tobacco processors, as well as to commodity dealers, continued their seasonal decline, and loans to sales finance companies, reflecting lower levels of consumer durable goods purchases, were off for the month. Borrowing by textile and apparel concerns reversed the declining tendency of previous months and increased slightly in February.

New York City banks increased their lending activity in February and the business loans of the weekly reporting City banks increased 99 million dollars in the four weeks ended February 27, to a total of 7,890 million dollars. This loan figure is the next to the highest on record, second only to the 7,933 million on December 26 last year.

CONTROL OF INFLATION IN THE NETHERLANDS

The Netherlands has made rapid progress since mid-1951 toward economic stability both domestically and in its foreign commercial and financial relations. In combating the renewed inflationary pressure and the critical deterioration in its external position that developed in 1950, particularly after the outbreak of the Korean hostilities, the Netherlands resorted primarily to monetary restraint, while at the same time reducing non-defense government expenditures, particularly for consumption subsidies and capital investment. The new policy marked a definite departure from the one followed during the earlier postwar years, when the Dutch Government relied primarily on direct controls over imports, investment, and consumption, coupled with price and wage controls and heavy government subsidies on staple foods. Up to 1950 there had been little resort to credit controls as an anti-inflationary measure, apart from a selective screening of loans by the central bank.

This rehabilitation of monetary policy followed the realization that the inflationary pressures of the last two years could no longer be satisfactorily controlled by the techniques used in the earlier postwar years. During 1945-49 the prevailing inflationary pressures were largely the result of a very high rate of investment, which was considered necessary in a country that had emerged from the Second World War with particularly heavy destruction of its agricultural and industrial plant and merchant marine, and a severe loss of income from overseas investment. In addition, the outlays in what is now Indonesia

involved a heavy drain on Dutch resources, while at home it was necessary to provide employment for a rapidly growing population. It was under these conditions that the country embarked upon a long-term program of economic reconstruction, while endeavoring to check inflationary pressures principally by direct controls. Balance-of-payments deficits were very large, particularly in 1947 and 1948, but these in part reflected a deliberate sacrifice of a large part of private and government foreign assets, as well as substantial financial aid from the United States, in the effort to speed up Dutch economic rehabilitation and reconstruction.

During 1949, the economic situation improved markedly; output rose considerably above prewar, direct controls were largely removed, and government borrowing from the banking system was reduced, while the international position also improved. It is true that the country apparently was still investing more than it could afford out of its own resources, but this was done without generating uncontrollable inflationary pressure. In consequence of this improvement, the Netherlands was able to join the Western European endeavor to liberalize intra-European trade, and in particular, to remove almost entirely the barriers to trade with Belgium and Luxembourg at the beginning of 1950.

The outbreak of hostilities in Korea and the subsequent repercussions on world economic conditions were followed in the Netherlands by renewed inflationary pressures, and the

country's international financial position greatly deteriorated. In a country as dependent on foreign trade as the Netherlands, world price trends of course greatly affect domestic conditions. The 30 per cent guilder devaluation of September 1949 had already brought about higher import prices in terms of guilders; and the post-Korea world price developments greatly accentuated the trend. From June 1949 to June 1951 the Netherlands terms of trade deteriorated by 17 per cent, thus necessitating a larger volume of exports for a given volume of imports. Nevertheless, only a portion of the increase in the Dutch trade deficit was attributable to the deterioration in the terms of trade; it primarily reflected a considerable rise in the volume of imports, which increased by 47 per cent from the first half of 1949 to the first half of 1951. Although exports also increased substantially during the same period, the trade deficit rose from the equivalent of 360 million dollars to 457 million.

The increased volume of imports was accounted for principally by consumer goods and raw materials, the rise in investment goods being quite small. Hence, it was apparently the restocking of Dutch inventories of imported goods that was chiefly responsible for the marked deterioration in the country's international position. The inventory accumulation in turn reflected the relaxation of import restrictions under the intra-European, and especially the Benelux, trade liberalization program, as well as accelerated buying in anticipation of further price rises. This inventory accumulation was financed partly by the redemption or sale of large amounts of treasury bills in the hands of the trading community, and since the treasury's resources were inadequate to meet the redemption of bills, direct government borrowing from the central bank increased by a moderate amount. The inventory accumulation was also financed to a considerable extent by additional borrowing from the commercial banks. Bank credit to business, which had been expanding relatively slowly, increased by almost 20 per cent in 1950 and rose at a comparable rate in the first quarter of 1951 before being brought under control in the second quarter. It was this commercial bank credit expansion and "its irrefutable connection" with the import financing and the consequent balance-of-payments deficit that prompted the Dutch monetary authorities to raise the official discount rate in September 1950 and introduce quantitative credit restrictions at the year end.¹

The increase in the central bank's discount rate from 2½ to 3 per cent in September 1950 was the first rate change since 1941; it was followed in April 1951 by a further rise to 4 per cent. Furthermore, in order to make the discount rate more effective, the commercial banks have been required since January 1951 to maintain a reserve in cash and short-term

government paper.² These requirements, the first of their kind in Dutch banking history, were designed to limit drastically the banks' freedom to substitute commercial loans for treasury paper in their portfolios; the ease with which such debt monetization could take place before January 1951 had been the major reason for the banks' ability to expand their commercial loans without impairing their liquidity.

While the monetary authorities were thus strengthening their controls over the money market, the Dutch Government evolved an anti-inflationary fiscal program. This program aimed at an over-all reduction in demand through a 5 per cent cut in consumption, a 25 per cent cut in private investment, and a sizable decrease in nondefense government expenditure. The cost-of-living subsidies on staple food items were reduced. The government negotiated an agreement with labor that up to 5 per cent of any cost-of-living increases after September 1950 would not be compensated by higher wages. Government investment was reduced, primarily through a cut in housing subsidies. New taxes to meet part of the increased defense expenditures were enacted by Parliament in August 1951. In general, the government relied on its monetary and fiscal measures to bring about the desired reduction in consumption and private investment, refraining from the reintroduction of over-all price and material controls. Import controls were tightened only slightly, while the government reaffirmed its intention of fulfilling its obligations under the trade liberalization code of the Organization for European Economic Cooperation.

These measures of monetary and fiscal restraint soon began to exert a pronounced influence on the domestic money and capital markets. While the commercial banks as a group retained early in 1951 a moderate margin of reserves in excess of those required by the new regulations, their lending policies became more cautious as they approached the point where they would have to rediscount at the central bank, since such discounts are traditionally considered undesirable by the Dutch banks.

On the capital market, a substantial rise in the entire interest rate structure also took place. Widespread drawing on savings to finance current consumption, and the uncertainty created by the government's retreat from its easy money policies, reduced the supply of investable funds at the same time that the heavy demand for defense, housing, and industrial expansion continued to exert pressure on the limited supply. During 1951, the average yield of government bonds rose from 3.23 to 3.55 per cent, while the yield of industrial bonds went up from 3.27 to 4.76 per cent. Under these conditions the Dutch Government reconsidered its postwar borrowing policy, which had

² Special provisions, however, enable banks to modify the impact of these reserve requirements if they limit their commercial loan portfolios to 105 per cent of the September 1950 level.

¹ De Nederlandsche Bank, *Report for the Year 1950*, page 45.

been based on a maximum rate of interest of 3 per cent on long-term bonds, and raised this rate to 4 per cent.

Along with these developments in the financial markets, prices became stabilized and in some cases declined. The reversal in the upward trend of world raw material prices in the spring of 1951, together with the tighter internal monetary policy, brought about a change in business and consumer expectations. The heavy inventory accumulation of the early post-Korea months left many businesses overstocked and compelled a liquidation of inventories. Wholesale and retail prices, after reaching all-time highs in May and April 1951, respectively, remained stable at slightly lower levels during the rest of the year. More or less simultaneously, industrial production leveled off and has subsequently declined somewhat in response to the slackening of consumer demand. While this lag in industrial production and consumer demand is expected to facilitate the transfer of productive resources to the rearmament industries, it is also necessarily accompanied by some increase in unemployment. Apparently largely because of transitional factors, there was a moderate increase in total unemployment in the Netherlands over the past year—to somewhat over 4 per cent of the labor force in January 1952, from close to 3 per cent in January 1951.

Moreover, the effective restriction of domestic demand contributed greatly to a rapid improvement of the Dutch external position after July 1951. Imports dropped sharply as inventory accumulation slowed down, while many producers for the first time since the war found it necessary to turn to foreign markets in order to sell their output, thus increasing the volume of exports. During the second half of 1951, exports rose in value by 17 per cent and imports fell by 12 per cent as compared with the first half of the year, the trade deficit decreasing from the equivalent of 457 million dollars to 130 million.

The over-all balance-of-payments position has also registered a noteworthy improvement. Since the midsummer of 1951, the greatly reduced trade deficit has been more than offset by a surplus on invisible account together with dollar aid receipts. As a result, net reserves (after taking account of both assets and liabilities under bilateral and European Payments Union agreements), which had declined to the equivalent of 241 million dollars in July 1951, rose steadily to 562 million in late February 1952.

Perhaps the most striking change in the Dutch external position has been the shift of the Netherlands to a creditor position in the European Payments Union, reflecting the improvement in payments relations with the other OEEC countries and their overseas monetary areas. From July 1950, when the EPU commenced operations, through July 1951, the Netherlands had a net deficit in every monthly accounting, and accordingly had to make use of up to 75 per cent of its quota. However, from August 1951 to January 1952, the Netherlands had surpluses

totaling 343 million dollars, as a result of which the accumulated deficit was wiped out by January and the Netherlands became a creditor country in the EPU (see table).

While the crisis in the Netherlands external position has abated in recent months, the Dutch Government is taking the view that the country's difficulties have by no means been overcome completely. It has already been pointed out that the stabilization program has been greatly helped by the leveling off of international raw material prices, available data indicating that the deterioration in the terms of trade slowed substantially in the fall of 1951. However, a renewal of raw material price increases could seriously endanger the gains of the Dutch economy unless exports were still further increased.

In addition to the more favorable trend of import prices, the Dutch balance-of-payments position has recently been strengthened by a number of temporary factors. Germany, after overcoming its own payments crisis, has made several large repayments of outstanding bilateral debts to the Netherlands. The Belgian Government has agreed to a postponement of the service on the Dutch intergovernmental debt. Lastly, some speculative inflow of capital into the Netherlands is reported to have occurred in the fall months of 1951. On the other hand, the recent British and French import cuts are expected to affect the Netherlands adversely; in the year ended June 30, 1951 these countries purchased 20 per cent of all Dutch exports.

The present policies of the Dutch authorities call for the continuation of the country's stabilization program. The government has stated its intention of continuing to enforce the 5 per cent cut in consumption at least through 1952, while the government budget for 1952 foresees a deficit equivalent to only 70 million dollars, as against a prediction of 220 million which had been made for 1951. Further cuts are to be made in housing construction, while defense expenditures are to be held to the equivalent of 394 million dollars (29 per cent of all government expenditures). On the other hand, the progress of the stabilization program was considered sufficient to permit

Netherlands Position in the European Payments Union,
July 1950-January 1952
(In millions of dollars)

Period	Cumulative surplus (+) or deficit (-) at end of period	Monthly rate of surplus (+) or deficit (-) during period	Per cent of quota used as of end of period*
1950 July-December.....	-107.8	-18.0	23.6
1951 January-June.....	-271.0	-27.2	73.0
July.....	-297.3	-26.3	75.3
August.....	-271.5	+25.7	68.0
September.....	-220.8	+50.8	53.7
October.....	-147.6	+73.2	33.1
November.....	-96.2	+51.4	18.6
December.....	-53.1	+43.2	6.5
1952 January.....	+45.6	+98.7	21.3

Note: Owing to rounding, the various figures may not be precisely reconcilable with one another.

* The Dutch quota was 330 million dollars until July 1, 1951, when it was raised to 355 million. In addition, the Netherlands had the use of 30 million dollars of initial resources before beginning to use its quota. The percentage figures take both of these adjustments into account.

Source: Press releases of the Organization for European Economic Cooperation.

a reduction in the discount rate of the Nederlandsche Bank from 4 to 3½ per cent on January 22, 1952.

Altogether, the Dutch anti-inflationary policy since the Second World War offers an interesting example in adaptation to changing economic conditions. During the early postwar years stress was laid on direct controls over investment and consumption, while indirect monetary and fiscal controls were considered inappropriate for coping with the type of inflationary pressures then prevailing (that is, pressures which were

mainly due to the shortage of consumption goods and raw materials). When direct controls were gradually removed as the more serious shortages eased, a new type of inflation developed, characterized by excessive credit expansion, over-rapid restocking of business inventories and accelerated consumer buying, for which indirect monetary and fiscal controls proved more suitable. The entire experience illustrates the advantages of adaptability and flexibility in economic and financial policies in times of rapid economic change.

LIFE INSURANCE COMPANIES AND THE SECURITY MARKETS

The steadily increasing popularity of life insurance has made the life insurance companies as a group the largest single depository of the public's savings. The task of investing these savings in the capital markets of the country has consequently been a growing one, and individual life insurance companies have found themselves faced with the problems of safely and profitably investing very large sums each year. Over the last 30 years, the total assets of the legal life insurance companies have grown 8½ times, to an estimated total of about 68 billion dollars at the end of 1951. The rate of growth in the assets of the life insurance companies between 1920 and 1950 was greater than that for the mutual savings banks, the savings and loan associations, and the fire and casualty insurance companies, and also exceeded the rate of increase in commercial bank holdings of Government securities and long-term earning assets. This article, and another to follow in a subsequent issue of this *Review*, will summarize some of the notable characteristics, and the implications, of the growing importance of life insurance companies in the capital markets.

The substantial growth of funds available to the life insurance companies for investment has, along with other developments of recent years, resulted in a considerable shrinkage in the importance of the traditional security markets and in the reliance placed upon the sales machinery of the investment banking houses in financing corporate capital expansion. There has consequently been an accompanying reduction in the volume of market transactions in outstanding corporate bonds. A relatively new mechanism for long-term industrial financing, the direct negotiation between borrower and lender, has developed as a natural consequence of the collection of large pools of funds by the insurance companies, and the necessity of keeping those funds fully and profitably employed.

The very extent of life insurance investment activities has raised the total demand for corporate debt instruments substantially. Over the years, competition for corporate debt securities has grown considerably, among the life insurance companies themselves, and between these companies as a group and other investors. This competition has probably been much keener during periods of relatively depressed business condi-

tions, such as in the thirties, because of the dearth of new corporate obligations and the relative stability of the flow of savings into the life insurance companies and some other types of institutional investors. The persistence of this demand may at times have had some tendency to reduce the cost of long-term corporate borrowing. However, the low rates of return on corporate (and other) debt securities over the past 20 years have been a reflection principally of national credit conditions and policies, and, together with the competition for corporate obligations, have brought an increasing interest on the part of life insurance companies and others in new outlets for funds. The search for new outlets has to some extent resulted in placing institutions with fiduciary responsibilities in the role of owner rather than creditor, through such programs as sale-and-lease-back and purchase-lease arrangements (especially for real estate and railroads), limited purchase of equity securities, and multi-family housing developments.

The impact of the growth of life insurance investments on the security markets may be summarized in terms of their own investment practices, the competition for securities between the life insurance companies and other investors, the structure and liquidity of the security markets, and the functioning of the investment machinery of those markets. Only the first of these—the investment practices of the insurance companies as they relate to corporate borrowing—will be discussed in detail in the present article.

This impact, of course, cannot be isolated from other developments in the capital market which have had profound effect on the volume and distribution of the flow of savings into the market and on the volume and types of investments becoming available for the absorption of those savings, and which have likewise had important bearing on the volume of funds and types of investments available to the life insurance companies. Among these developments, the quest for safety of principal by individuals suffering heavy losses during the 1929 stock market crash and during the depression of the thirties, and the increasing relative importance of the savings of the lower income groups which normally place their funds in life insurance, savings deposits, and other secure forms of savings have

tended to increase the relative flow of individual savings to institutional investors since the twenties. More significant for its immediate impact on the bond market has been the sharp increase over this period in Federal income taxation, of which a particularly heavy burden has been placed on wealthy individuals (including personal trust accounts) and on business and financial corporations. The net effect of higher taxes has been to compartmentalize the bond market, tax-exempt securities becoming increasingly the favored outlet for the funds of individuals, personal trust accounts, and institutional investors subject to taxation, and corporate obligations becoming increasingly the outlet for institutional investors not subject to substantial taxation, particularly the life insurance companies. Finally, the long period of low money rates since the early thirties has made corporate bond yields less attractive to individual investors, especially after taxes. At the same time, the low cost of borrowed funds encouraged corporations to issue debt securities when seeking external funds; and the facts that dividend yields on common stocks were high during a large part of this period and that dividends are payable after taxes, whereas interest is an expense of business and so deductible from income before taxes, were even more important stimulants to the flotation of debt securities when external financing became necessary. The growth of life insurance company investments, nevertheless, has had an important impact on the security markets apart from, as well as in conjunction with, these other developments.

GROWTH OF LIFE INSURANCE COMPANY INVESTMENT OPERATIONS

The vast scope of the operations of the life insurance companies may be measured in several ways. First, the reserves established by the life insurance companies to meet their obligations to policyholders aggregated 55 billion dollars at the end of 1950, somewhat more than double such reserves before the war, and accounted for almost one third of the total savings lodged in major financial institutions and Government Savings bonds together. Second, the absolute amounts of new savings channeled into life insurance companies each year have been large and growing, and have shown unusual resistance to the influences that have caused declines in other forms of saving during depression. Premium income from life insurance policies and annuities fell from 3.7 billion dollars in 1931 to 3.5 and 3.3 billion dollars in 1932 and 1933, respectively, but was always in excess of operating disbursements, with the result that net reserves increased even during the leanest years of the great depression. In each year during and since the war, of course, the net amounts of funds available to life insurance companies for investment have grown substantially, rising from 1.5 billion dollars in 1939 to approximately 4.3 billion in 1951. Over a long period of years following World War I the net amount of funds available grew substantially, not only in dollar

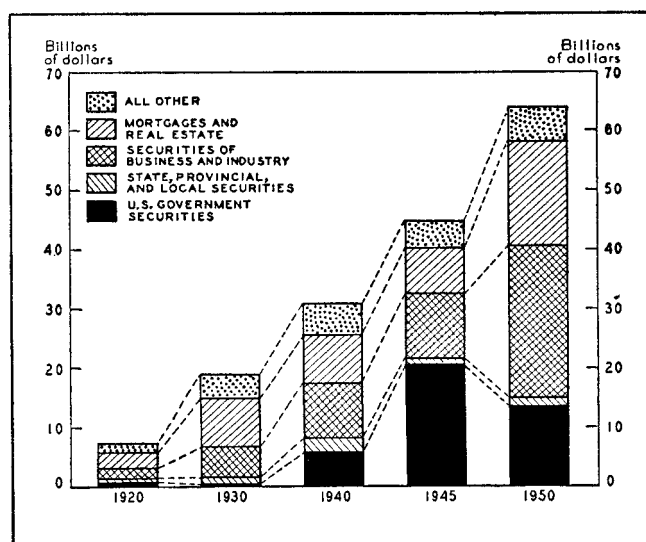
amounts but also in relation to the increase in total public and private long-term debt outstanding. Third, the gross amount of funds for which life insurance companies must annually find productive employment substantially exceeds the net increase in assets because the companies also receive funds from periodic repayments, redemptions, and retirement of mortgages, securities, and other assets. In addition, during the past several years life insurance companies have obtained large sums for the purchase of new, higher-yielding investments by selling substantial amounts of lower-yielding Government securities purchased during the wartime period.

LIFE INSURANCE COMPANY HOLDINGS OF CORPORATE BONDS

In investing a larger and larger volume of funds, the life insurance companies have generally indicated a preference for the better grades of corporate debt securities, because they afford the most convenient outlet, of suitable quality, for substantial amounts of funds at adequate rates of return and at a minimum of originating and supervising costs. In the mortgage market, on the other hand, large numbers of transactions each involving small loans are the general rule, and municipal securities do not yield adequate returns. Thus, for the larger companies at least, corporate obligations have been a means of greatly easing the investment burden and reducing investment cost. However, the net yield on such issues has not been as large as the return on most mortgages, even after the added expense of placing and keeping the latter on the books. Consequently, life insurance companies have also accelerated their acquisitions of mortgages in the postwar years.

Nevertheless, providing for the long-term capital needs of business corporations has become one of the most important

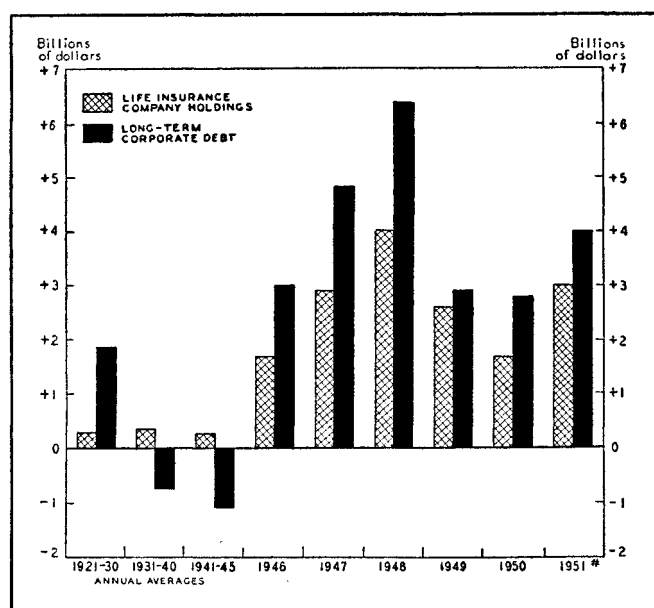
Chart I
Distribution of Assets of All Life Insurance Companies



Source: Institute of Life Insurance, *Life Insurance Fact Book*.

Chart II

Changes in Net Long-Term Debt of All U. S. Business Corporations and in Life Insurance Company Holdings of Securities of Business and Industry



Net change in corporate indebtedness in 1951 estimated by the Federal Reserve Bank of New York.

Sources: Institute of Life Insurance and U. S. Department of Commerce.

investment activities of the life insurance companies during peacetime. As shown in Chart I, life insurance company holdings of long-term corporate debt securities have increased steadily and rapidly since 1920. By 1936, they exceeded mortgage investments. The leading role played by the life insurance companies in the corporate bond market during recent years is shown in the second chart. In the six postwar years beginning with 1946, these companies' holdings of corporate bonds (including relatively small amounts of foreign corporate issues and those of miscellaneous debtors) increased by an estimated 16.2 billion dollars, or more than two thirds of the estimated total increase in outstanding long-term corporate debt (23.9 billion dollars). In contrast, in the decade of the twenties, following World War I, the life insurance companies' net purchases of corporate bonds came to only about one sixth of the net increase in corporate long-term indebtedness. Throughout the thirties and the war years, the life insurance companies continued to add to their holdings of business debt securities even though total corporate indebtedness declined. By the end of 1951, it is estimated that their holdings had risen to over 40 per cent of the total outstanding.

Although holdings of corporate obligations by life insurance companies are very large in the aggregate, there is wide variation in the importance of such issues among individual companies. In particular, corporate debt issues are much less prominent in the portfolios of the smaller companies than in

the larger ones. For example, total business securities of 17 companies with assets of less than 200 million dollars each accounted for less than a fourth of their total assets at the end of October 1951, as compared with more than two fifths for the 13 companies each with assets of one billion dollars or more. Mortgage holdings of the smaller companies, furthermore, were larger in dollar amount than business security holdings, whereas for the largest companies (with assets of a billion dollars and over) mortgages amounted to only 55 per cent of their business security investments. In the composition of their assets, the smaller companies more closely resemble the savings banks rather than the larger life insurance companies.

These differences reflect perhaps principally the more largely local or regional character of the investments of the smaller life insurance companies. Their investment acquisitions being more frequently local in character are presumably more likely to take the form of mortgages, instead of the securities available in the national capital market. This preference may also stem from a better rate of return on local obligations.

GROWTH OF DIRECT OR PRIVATE PLACEMENTS

As already suggested above, direct placements came into use chiefly as a result of the growing volume of investable funds in the large insurance companies. Although the smaller insurance companies also have made "direct or private placements" of securities, their activities in this area are more limited.¹

Circumstances apparently became increasingly opportune for direct negotiation of new security issues during the depressed years of the thirties. Because the aggregate indebtedness of business corporations was falling off in this period, life insurance companies experienced considerable difficulty in investing all of their available funds. Investment bankers floating refunding issues or new capital issues of those corporations seeking funds, on the other hand, found that wide distribution of new issues to investors scattered all over the country was no longer necessary, since the demand for new bond issues from large institutional investors exceeded the supply of such issues available.

Direct negotiation of new security issues between corporate borrowers and life insurance company lenders (or other lenders), which apparently had been a practice of long stand-

¹ A study of the 22 largest life insurance companies showed that, while the four largest at the end of 1949 held 58.5 per cent of the combined assets of the group, these same four held 67.4 per cent of the combined private placements of all 22. The four smallest of these companies, by contrast, held 3.9 per cent of the combined assets as against 1.1 per cent of the combined private placements. Cf., "The Pros and Cons of Direct Placement" by Frazar B. Wilde, a speech delivered before the Financial Section of the American Life Convention, October 6, 1950. E. V. Hale and Company, in their analysis of the 1950 direct placements of life insurance companies with assets of 10 million dollars or more at the end of that year, listed 154 (mostly small) companies for which no direct purchases of securities were found.

ing but limited scope before the thirties,² was also given impetus by the passage of the Securities Act of 1933. This Act, in order to correct abuses that had worked particular hardship on smaller investors who purchased securities listed on the organized exchanges, required corporate issuers to file registration statements with the Securities and Exchange Commission. These statements had to provide considerable information with respect to proposed new issues and business operations, and the Act placed legal liabilities on officers and directors and others responsible for the accuracy of such statements. It also required a waiting period between filing the registration statement and offering a new issue for sale, in order to permit review of the information prior to the appearance of the securities in the market. However, during that waiting period, changing market conditions could alter the chances of success of a new issue or result in considerable change in the terms of the offering. Exempt from such registration because they are offered to a limited number of investors, privately placed securities were a means of avoiding the delays, expense, and uncertainties entailed in the SEC procedure. Presumably, in selling securities directly to large lenders, corporate management could make necessary information available to a limited number of investors without widespread publicity.

Increasing Federal personal and corporate income tax rates, furthermore, and the low yields on most bonds, reflecting the over-all lack of demand for long-term funds and the prevailing monetary policy during the thirties, made corporate debt issues less attractive to wealthy individual investors, personal trust funds, and to institutional investors subject to corporate taxes. These investors, in some measure, found more favorable opportunities in tax-exempt securities. At the same time, however, rising corporate tax rates and declining interest costs persuaded those corporations which did have occasion to seek new funds to raise them through debt rather than equity securities.

With the exception of the war years, the volume of these so-called direct or private placements of securities has grown steadily since 1934, and in recent years has ranged between 2½ and 3½ billion dollars annually, or from one third to more than two fifths of all new corporate security flotations. The bulk of these private security placements consists of debenture bonds and notes, and the life insurance companies have recently been absorbing about 90 per cent of them. Since 1947, total private placements have exceeded 50 per cent of corporate debt security offerings, reaching nearly 60 per cent last year. Because Federal regulatory agencies and those of several States require that most public utility and railroad security offerings be made

at competitive bidding, the largest part of the privately placed issues consists of securities of industrial and financial corporations, including manufacturing, mining, trade, and sales and personal finance companies.

It is chiefly through the vehicle of private placements, therefore, that "industrial" bonds have become a significant portion of life insurance company investments—9.5 billion dollars or almost 15 per cent of assets at the end of 1950, as compared with less than 300 million and 1.6 per cent of assets at the end of 1929. Public utility bond holdings as a fraction of total assets have grown much more slowly between these two years, from 8 per cent at the earlier date to 16½ per cent last year. Life insurance company investments in railroad bonds, on the other hand, increased only 355 million dollars over this period, and fell from 16 per cent of assets at the end of 1929 to 5 per cent at the close of 1950. However, the small increase in their holdings of railroad obligations occurred in spite of a substantial decline in total railroad indebtedness in this period.

Their ability to provide long-term funds in large amounts has gained for the larger life insurance companies a competitive advantage over other types of investors in securing investments directly from corporate issuers, an advantage which only the growing self-administered and trustee pension funds may eventually encroach upon. That private placements will remain an important method of long-term corporate financing seems assured. Corporate borrowers apparently have placed a high value upon the convenience of direct borrowing, and have been willing on occasion to undertake such arrangements when the interest rate was slightly higher than might have been obtained with a registered market offering. A number of new bond issues have been floated in the market at a lower net interest cost to the issuer than the net interest cost on private placements made by comparable borrowers. Corporate financial management has probably been most strongly attracted by the flexibility of private loan agreements, the ease with which additional funds may be secured once relationships between borrower and lender have been established, and the ability to secure firm commitments in advance, to defer drawing down funds until they are needed, and to obtain funds regardless of price conditions in the market.

Undoubtedly many borrowing corporations have used private placements because they wanted assurance that definite sums would be made available to them at some future time, in accordance with the schedules of their estimated needs. In return for such assurance, the borrower usually pays a commitment fee of ½ of 1 to 1 per cent until the funds are drawn down, and thereafter the regular interest rate (as determined during the negotiations) applies. A marked acceleration in the volume of life insurance company corporate security commitments during 1950 and early 1951 reflected mainly the sharp step-up of business capital expenditures and expansion plans

² See, Fraine, H. G., "Direct Sale of Security Issues", *Journal of the American Association of University Teachers of Insurance*, March 1949.

resulting from the war in Korea and the Government's defense program.³

For the life insurance companies, the private placement technique provides a desired opportunity to earmark in advance the employment of a part of the funds that are expected several months later on, thus easing the investment burden. The development of close relationships with corporate borrowers, moreover, tends to build repeat loan business for the life insurance companies and also enables them to become thoroughly familiar with the borrower's business operations and financial status. Direct placements may also enable the lender to impose protective conditions, many of which would not be suitable or possible in the case of a publicly offered bond issue. These include provisions for sinking fund and pay-out clauses, and various covenants limiting to some extent the borrower's financial operations (such as the maintenance of working capital at a specified level, or restrictions on the pledge or sale of assets). What is more important, these terms can be tailored to the individual transaction, including both the borrower's and lender's requirements, in order to provide better security for the loan. Very often, too, life insurance companies receive higher yields on securities purchased directly than on market purchases, not only because of a tendency to set a price for securities which allows the lenders to share a portion of the savings in expense of floating a public offering, but also because the life insurance company (or a small group of companies where a few lenders participate in an issue) assumes the risk of the entire transaction. In connection with a public offering in February 1952 of a 125 million dollar twelve-year issue of $3\frac{1}{8}$ per cent debenture bonds of the Aluminum Corporation of America, for example,

³ A similar acceleration of residential mortgage commitments was related to efforts of builders and potential home owners to "beat" the more restrictive terms of Federal real estate credit regulation.

it was reported by the underwriter heading the syndicate that the issuer "could not have negotiated the transaction on a private placement basis for less than $3\frac{1}{2}$ per cent".⁴

The foregoing discussion suggests that the private placement has drawbacks as well as advantages from the investment point of view. To the insurance company, the lack of ready marketability may mean that it may be frozen in, perhaps for large sums, should an issue turn "sour", although a number of safeguards have been adopted to mitigate the adverse effects of such an eventuality. As a balancing consideration, it is probably also true that many listed and over-the-counter bond issues have a limited or doubtful marketability, especially when a bondholder tries to dispose of a sizable block of bonds. As for the borrowing corporation, it may pay a higher yield on a directly placed issue than one offered in the public market. It also loses the privilege of repurchasing its securities at a discount for sinking fund or other purposes should interest rates subsequently rise (sinking funds in direct placements usually provide for payments at par), a disadvantage which may become very real in a flexible bond market. The management of borrowing corporations may also find some objection to the limitations occasionally placed on financial operations by the terms of a direct placement agreement. On the whole, however, the advantages of the direct placement technique apparently outweigh considerably the disadvantages in a large number of borrowing situations.

A second article to appear in a forthcoming issue of this *Review* will deal with the impact of the growth of life insurance investments on other investors and investing institutions, and on the functioning of the security markets and the traditional methods of marketing new corporate debt issues.

⁴ *The New York Times*, January 30, 1952, page 39.

PRODUCTION IN A DEFENSE ECONOMY

Industrial production in the opening months of 1952 appears to have stabilized at the same level which characterized most of 1951. Despite the impact of the defense program and heavy capital expenditures by business, the Federal Reserve index of industrial production was no higher at the end of 1951 than it was a year earlier. Output in current months has actually been slightly lower than in the corresponding period of 1951. Yet this over-all stability has been deceptive. Marked shifts have occurred in the nature and composition of the nation's output. Defense, capital goods, and basic metals industries have been increasing production substantially, at the same time that many civilian goods lines have been cutting their activity sharply. Materials shortages, arising from heavy defense needs, have restricted consumer durable goods output, but activity has also been affected markedly by a drop in consumer demand. In nondurable goods lines, the chief causes of cur-

tailed production have been declining orders and heavy inventories.

The defense program has played an increasingly important role in industrial production over the past year and a half. It could be argued, however, that the direct effects of defense production now being felt are not nearly so upsetting to the economy as were the anticipatory effects a year or so ago. After the start of the Korean war, and again after the Chinese Communist intervention, fears and rumors of shortages or price increases touched off large-scale buying by both business and consumers. The shortages failed to appear, prices declined, and inventory congestion plagued industry throughout most of the past year. In part, this reversal reflected the tremendous productive capacity of the American economy, but it also stemmed from widespread misapprehensions about the impact and timing of the defense program.

In the first 18 months of the Korean conflict, the share of the total national output accounted for by all types of Government expenditures for national security rose from 6 per cent to 13½ per cent. This, however, is far short of the more than 40 per cent devoted to defense at the height of World War II. By the beginning of 1952, actual deliveries of military goods and construction had reached a rate of over 2 billion dollars per month, approximately triple what they were a year earlier. Yet these increased expenditures for final products represent only a fraction of the current impact of the defense effort. At present, a large share of the program is being privately financed. Private businesses holding defense contracts have been spending large sums of money and using large quantities of materials to build or convert facilities, to obtain tools and working stocks, and to start the processing of goods which may not be delivered as finished weapons for many months to come.

One means of gauging the growth of defense activity is the increasing quantities of metal going into military production. Allocations for the second quarter of 1952 indicate that producers of military items are scheduled to receive 35 per cent more steel, compared with the fourth quarter of 1951. They will be using approximately 45 per cent more copper, and 60 per cent more aluminum. For the second quarter, military production has been allocated approximately one eighth of the total steel supply, one fourth of the copper, and three eighths of the aluminum. Moreover, these allotments cover only direct military production; additional supplies are used indirectly for production of component parts, while such vital defense-supporting programs as atomic energy, machine tools, industrial construction, and electric power expansion receive separate allocations and correspondingly reduce supplies available for purely civilian uses.

In the second quarter of this year, quantities of scarce materials taken for military use are scheduled to be increased further. At the same time, however, supplies of these materials are expected to increase somewhat as some of the expanded facilities for production of basic materials (a fundamental part of the defense program) start producing, and further increases are scheduled for late 1952 and 1953. Defense officials have indicated that the share of scarce materials going into military production may be approaching its peak by the middle of 1952. This does not necessarily mean plentiful supplies for civilian production; the pinch on materials will persist as the defense program continues to chew up materials at a high rate. Nor will a leveling off in the input of materials mean that the output of finished defense goods is similarly near its peak. There is a long time lag for many weapons between the initial processing of the basic metal and the delivery of the finished product. New plants must obtain working inventories, the flow of component parts from suppliers must be begun and smoothed out, and vast quantities of goods in process may be

held up by a bottleneck shortage of some small but strategic item. Under current schedules, military deliveries as a whole are not expected to reach a peak until the early part of 1953 and certain individual programs, including aircraft, may not reach their highest production rates until some time in 1954.

This build-up of defense production has been part of a deliberate program which emphasizes not only actual output of munitions but also the expansion of basic productive capacity and the creation of facilities for rapid expansion of military output if necessary. In the current situation the program is essentially a defensive one, and there has been no desire to maximize rapidly the output of planes, tanks, and guns (which might soon become obsolescent) at the expense of the civilian economy. Rather, the object has been to expand our potential military strength while maintaining a relatively high level of civilian goods output. The defense program has been subject to adjustments from time to time, the latest of which, announced in January, involved the decision to stretch the program out over a longer period, perhaps several years, at peak rates, instead of building up to a still higher peak and then dropping off.

The chief manifestation of the defense program so far has been its effect on the supplies of various basic materials. As noted earlier, the demand for materials has come not only from actual military production but also from the defense-supporting programs for expanding industrial plants and facilities. The principal method of controlling the use of scarce materials is the Controlled Materials Plan, or CMP, under which the total supply of steel, copper, and aluminum is divided up among military and civilian uses. All three of these metals have been hard to get, and, particularly in the case of copper, the pinch is expected to continue. Both the steel and aluminum industries, however, are expanding their basic capacity, and eventually some easing of supplies is expected. The tight scrap supply may prove to be a limiting factor on steel output. Nevertheless, certain types of steel are already easier to get than they were last fall, and inventories of numerous fabricators have been reported to be more than adequate for reduced rates of production. Trade journals have noted the virtual disappearance of the high-priced gray market for steel, while order backlogs of some small high-cost producers are no longer sufficient to maintain capacity operations. Cold-rolled strip, sheet, and chrome steel are definitely more plentiful, but the supply of many items, such as structural steel, plates, bars, and pipe, is still tight. Of course, the current supply situation could be seriously upset by strikes in the steel or coal industries this spring.

To some extent the easing of certain steel supplies may reflect the fact that many fabricators of civilian goods find their production rates regulated by the availability of copper and aluminum, whose use has generally been more sharply curtailed than that of steel. During the current quarter, producers of consumers' durable goods other than automobiles have been allo-

cated steel equal to about 50 per cent of what they used during their pre-Korea base period (the average of the first two quarters of 1950), but allotments of copper and aluminum are little more than one third of the base period consumption. Such an imbalance in allotments is likely to encourage substitution of relatively less critical materials for those which are scarcer. Automobile manufacturers are being allotted sufficient materials for 930,000 passenger cars in the first quarter of this year, although by substituting materials, economizing, and drawing down inventories they may produce as many as a million cars.

In the second quarter, rising military needs may pinch consumer goods producers even more tightly. Late in February, the NPA announced that steel allocations for consumer durable goods production during the second quarter will be continued at about the first-quarter rate, but that copper and aluminum will be cut by about one seventh. In some instances, however, this cut will be more apparent than real. In making its allotments for previous quarters, CMP officials had relied on World

War II experience and assumed that 10 to 15 per cent of the materials allocated to manufacturers and other users would never be claimed. When such attrition in the allotments failed to occur, many firms found themselves unable to obtain all the metal they were allocated. For the second quarter of 1952, therefore, total allocations were brought more closely into line with available supplies, and allotments to the various programs were correspondingly reduced. Since manufacturers are more likely to be able to obtain the full amounts allotted to them, however, actual deliveries will not be cut as much as allocations. Another source of relief for manufacturers lies in the adjustment of the defense program mentioned earlier. The Air Force has found that stretching out the defense program will allow it to turn back as much as 35 million pounds of aluminum already allotted for military production in the second quarter, while the Army is turning back nearly 10 million pounds of copper. Some of this will be reallocated for nondefense uses. Already one million pounds of aluminum have been added to the allotment for automobile production,

Business Indicators

Item	Unit	1952	1951			Percentage change	
		January	December	November	January	Latest month from previous month	Latest month from year earlier
UNITED STATES							
<i>Production and trade</i>							
Industrial production*	1935-39 = 100	219p	218	219	221	#	- 1
Electric power output*	1935-39 = 100	—	342	338	318	+ 1	+ 8
Ton-miles of railway freight*	1935-39 = 100	—	200p	198	208	+ 1	- 3
Manufacturers' sales*	billions of \$	—	21.3p	22.3	22.6	- 5	+ 1
Manufacturers' inventories*	billions of \$	—	42.0p	41.7	34.1	+ 1	+ 26
Manufacturers' new orders, total	billions of \$	—	21.3p	22.7	28.2	- 6	- 7
Manufacturers' new orders, durable goods	billions of \$	—	10.3p	11.1	15.1	- 7	- 12
Retail sales*††	billions of \$	12.6p	12.3	12.5	13.6	+ 2	- 8
Residential construction contracts*	1923-25 = 100	226p	240	243	312	- 6	- 28
Nonresidential construction contracts*	1923-25 = 100	364p	367	331	350	- 1	+ 4
<i>Prices, wages, and employment</i>							
Basic commodity prices†	Aug. 1939 = 100	323.8	328.1	327.5	383.9	- 1	- 16
Wholesale prices†**	1947-49 = 100	113.2p	113.5	113.6	115.0	#	- 2
Consumers' prices†	1935-39 = 100	189.1	189.1	188.6	181.5	#	+ 4
Personal income* (annual rate)	billions of \$	—	257.1p	256.5	243.6	#	+ 5
Composite index of wages and salaries*	1939 = 100	—	231p	230	219	+ 1	+ 7
Nonagricultural employment*	thousands	46,510p	46,525	46,473r	45,804r	#	+ 2
Manufacturing employment*	thousands	15,806p	15,808	15,773r	15,852r	#	#
Average hours worked per week, manufacturing†	hours	40.7p	41.2	40.5	41.0	- 1	- 1
Unemployment	thousands	2,054	1,674	1,828	2,503	+23	- 18
<i>Banking and finance</i>							
Total investments of all commercial banks	millions of \$	75,290p	75,070p	74,590p	72,340	#	+ 4
Total loans of all commercial banks	millions of \$	57,480p	58,300p	57,270p	52,710	- 1	+ 9
Total demand deposits adjusted	millions of \$	97,760p	98,120p	96,290p	91,600	#	+ 7
Currency outside the Treasury and Federal Reserve Banks*	millions of \$	28,551	28,850	28,526	27,222	- 1	+ 5
Bank debits* (U. S. outside New York City)	billions of \$	88.0	80.9	88.3	87.8	+ 9	#
Velocity of demand deposits* (U. S. outside New York City)	1935-39 = 100	96.3	98.6r	99.1	102.8	- 2	- 6
Consumer instalment credit outstanding†	millions of \$	13,313p	13,506	13,271r	13,252r	- 1	#
<i>United States Government finance (other than borrowing)</i>							
Cash income	millions of \$	5,192p	5,642	4,293	4,696	- 8	+ 11
Cash outgo	millions of \$	5,483p	5,621	5,642	3,438	- 2	+ 59
National defense expenditures	millions of \$	3,843	3,445r	3,430	1,870r	+12	+106
SECOND FEDERAL RESERVE DISTRICT							
Electric power output* (New York and New Jersey)	1935-39 = 100	—	235	233	224	+ 1	+ 6
Residential construction contracts*	1923-25 = 100	—	89p	94	213	- 6	- 45
Nonresidential construction contracts*	1923-25 = 100	—	160p	165	232	- 3	- 19
Consumers' prices† (New York City)	1935-39 = 100	184.2	184.0	184.1	177.8	#	+ 4
Nonagricultural employment*	thousands	—	7,321.8p	7,277.3	7,256.9r	+ 1	+ 1
Manufacturing employment*	thousands	2,662.4p	2,633.4	2,600.1	2,627.1r	+ 1	+ 1
Bank debits* (New York City)	billions of \$	46.3	44.2	48.2	46.4	+ 5	#
Bank debits* (Second District excluding N. Y. C. and Albany)	billions of \$	3.9	3.4	3.9	4.0r	+16	- 1
Velocity of demand deposits* (New York City)	1935-39 = 100	106.5	117.0	114.4	116.6r	- 9	- 9

p Preliminary. r Revised.

* Adjusted for seasonal variation.

** Revised series. Back data available from the U. S. Bureau of Labor Statistics.

Change of less than 0.5 per cent.

† Seasonal variations believed to be minor; no adjustment made.

†† Series revised from 1940 to date.

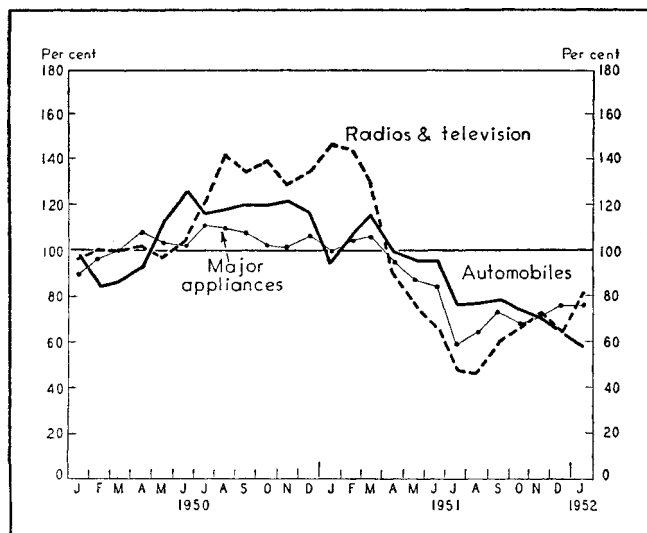
Source: A description of these series and their sources is available from the Domestic Research Division, Federal Reserve Bank of New York, on request.

while 3.5 million pounds each of copper and aluminum will go into a reserve for adjustment of consumer goods allotments.

The course of some of the major consumer durable goods industries during the past two years is shown in the following chart. Most manufacturers of consumer durables were still maintaining high rates of production a year ago, well above the pre-Korea base period. The subsequent drop did not reflect materials shortages or conversion to defense production in most cases; the trouble generally was excessive inventories. Both manufacturers and distributors had felt that, if shortages were coming soon, large inventories would be an advantage rather than a hindrance. But supplies of consumer durable goods continued to be ample, the high rate of spare buying ceased, and extensive promotions became necessary to attract customers. The most notable production decline occurred in the radio-television industry, whose output dropped to less than one third of its January 1951 peak, while production of major appliances was cut by nearly one half. Lines less affected by metals shortages also reduced activity; furniture output was down about one fourth and carpet manufacturers experienced a cutback of more than 60 per cent. There was some recovery in household durable goods production in the fall of 1951, but not all manufacturers produced as much as their materials allocations would allow. Consequently, despite the reduced allotments for the first quarter of 1952, over-all production rates for household durable goods may not be too far below those prevailing in the fourth quarter.

The automobile industry did not have the inventory problems of most other consumer durable goods producers. Throughout most of the latter half of the year, retail sales

Production of Selected Consumer Durable Goods, 1950-52
(Average, first half of 1950=100 per cent; adjusted for seasonal variation)*



* January 1952 figures are preliminary.

Source: Board of Governors of the Federal Reserve System; transferred to a new base by the Federal Reserve Bank of New York.

Changes in Output of Major Industries since the Start of the Korean War

Industry group	Peak month since June 1950	Per cent change		
		June 1950 to peak	Peak to January 1952	June 1950 to January 1952
Iron and steel.....	April 1951	+ 14	- 1	+ 13
Machinery.....	December 1951	+ 37	- 1	+ 36
Transportation equipment (except automobiles).....	December 1951	+135	- 1	+132
Automobiles (including parts).....	August 1950	+ 2	-21	- 19
Nonferrous metals and products.....	December 1950	+ 10	- 7	+ 2
Lumber and products.....	December 1950	+ 12	-10	0
Stone, clay, and glass products.....	April 1951	+ 18	-14	+ 1
Durable manufactures.....	December 1951	+ 19	0	+ 18
Textiles and products.....	October 1950	+ 14	-19	- 8
Leather and products.....	September 1950	+ 18	-29*	- 16*
Manufactured food products.....	August 1950	+ 2	- 5	- 3
Alcoholic beverages.....	August 1950	+ 35	-19*	- 4*
Tobacco products.....	August 1950	+ 16	-25*	- 14*
Paper and paper products.....	April 1951	+ 16	-13	+ 1
Printing and publishing.....	April 1951	+ 8	- 4	+ 3
Petroleum and coal products.....	December 1951	+ 26	†	+ 25
Chemical products.....	August 1951	+ 17	- 3	+ 14
Rubber products.....	October 1950	+ 14	- 1	+ 12
Nondurable manufactures.....	January 1951	+ 9	- 7	+ 2
Manufactures.....	March 1951	+ 13	- 2	+ 10
Fuels.....	October 1951	+ 15	- 3	+ 12
Metals.....	May 1951	+ 16	-26	- 14
Minerals.....	October 1951	+ 15	- 6	+ 9
Industrial production...	April 1951	+ 12	- 2	+ 10

* December 1951 data are latest available.

† Change of less than 0.5 per cent.

Source: Computed from seasonally adjusted indexes of the Board of Governors of the Federal Reserve System.

tended to exceed production, and except for some of the smaller manufacturers the production cutbacks were closely in line with those dictated by materials restrictions. By December 1951, however, output of passenger cars was down to less than half of the June 1950 rate. The consequent layoffs at automobile assembly plants have created localized unemployment problems, particularly in the Detroit area. As a result, defense production authorities have recently adopted measures designed to channel defense orders into areas of growing unemployment.

Not all of these centers of unemployment have been caused by materials restrictions, however. Many nondurable goods industries have been in the doldrums because of excessive inventories and lagging demand. Although the first indications of growing inventories and declining demand were noted nearly a year ago, the textile industry is still plagued by the congestion of stocks in the hands of processors and suppliers, and consequently the price situation is still weak and unsettled. The drop in demand has not been confined to cotton textiles; rayon and woolen mills have been at least equally hard hit. Military orders offset only a small part of the drop in civilian demand. Over 130,000 textile workers have been laid off since February 1951. Output of leather and leather products has not only dropped below the pre-Korea level, but also below the 1935-39 average. In addition, as the accompanying table indicates, other nondurable goods industries, including tobacco products, alcoholic beverages, paperboard, and

manufactured food products, have fallen below the level prevailing at the outbreak of the Korean war. However, certain nondurable goods industries have been directly stimulated by the defense program, notably petroleum refining and industrial chemicals, and the expansion in these groups has kept the average for the nondurable goods category currently at approximately the pre-Korea level.

Despite the currently weak position of certain industries,

the basic forces in the economy are still strong for the remainder of this year. Defense production will be on the increase during the months ahead. Businessmen are still planning a record volume of plant and equipment expenditures during 1952. Despite increased taxes, spendable incomes have reached a new peak. Even in those industries where some further adjustment of inventories remains to be accomplished, the prospects are for a recovery in activity once stocks are brought into line.

DEPARTMENT STORE TRADE

Department store sales in this District increased somewhat more than seasonally during February. Preliminary estimates indicate that the index of average daily sales, after adjustment for seasonal variation, reached 102 per cent of the 1947-49 base in February, a rise of 2 percentage points from the level of the previous month, but was about 9 per cent below the scare-buying-inflated sales volume of February 1951. On the basis of monthly totals, however, department store sales in February, bolstered by one more shopping day this year, amounted to only 4 per cent less than those of the same month last year.

While demand for durable homefurnishings continued to lag substantially behind year-ago levels, sales of men's and women's apparel reportedly compared very favorably with their corresponding 1951 figures. Retailers interpret the relatively strong showing of the apparel lines at this time as an indication of a successful spring season. Moreover, the later date of Easter this year (April 13 as against March 25, 1951) provides an additional three weeks of pre-Easter shopping which should allow the stores ample time for moving seasonal merchandise, thus possibly reducing the need for post-Easter markdowns of spring apparel.

DEPARTMENT STORE SALES BY TYPE OF MERCHANDISE IN 1951

Department store trade in this District in 1951 will probably be remembered chiefly for the wave of anticipatory buying of January and February, the midsummer "price war" in New York City, and the stores' intensive liquidation of excess inventories during the latter half of the year, when the sharply reduced tempo of retail activity became more than just a temporary reaction to a previous period of heavy consumer spending. There were, however, other trade developments which were also of great significance to retailers when relating the events of 1951 to an appraisal of their business prospects for 1952.

Perhaps the most noteworthy was the less spectacular but more consistent demand for nondurables (particularly women's apparel) during a year in which consumers reportedly saved the highest percentage of their incomes since World War II.

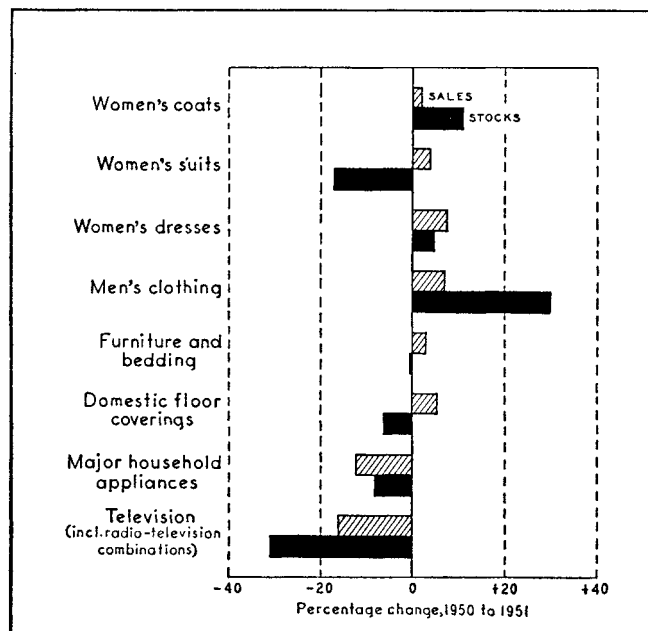
The more favorable sales performances (relative to year-ago levels) of many of the apparel lines during 1951 emphasized once again the comparatively greater resistance to decline that has been shown by nondurable goods.

With few exceptions, sales of nondurables in Second District department stores fared better (on a year-to-year basis) than did the major household durable goods. This was partially due, of course, to the exceptionally strong showing of the durable lines during the latter half of 1950 and also illustrates, to some extent, the greater degree of fluctuation in consumer purchases of these items. The greater variation in demand for durable goods occurs primarily because their high unit prices render them particularly sensitive to changes in consumer expectations of income, prices, and the availability of goods. Moreover, the very nature of the durable items precludes the necessity of regular replacement buying by consumers, in contrast with those nondurables which are more perishable or subject to short-run style changes.

However, not all of the major durables lines failed to improve upon their 1950 sales volume. Stimulated by the continued high rate of residential building, sales of furniture and bedding and of domestic floor coverings recorded gains of 3 and 5 per cent, respectively, from their corresponding 1950 dollar volume. On the other hand, demand for television sets and major appliances fell off sharply (compared with year-earlier levels) after February and except for a few brief periods of markedly increased retail activity, such as during the "price war" in June, sales of these goods were well below their 1950 levels.

This was generally not the case, however, with regard to the more important nondurable lines, especially men's and women's apparel. Sales of women's dresses, for example, registered year-to-year gains in each month of 1951, averaging 7 per cent above 1950 levels for the year as a whole. While consumer demand for women's coats and suits and men's clothing was not nearly as consistent, sales of these items for the year as a whole were up 2, 4, and 7 per cent, respectively, from their 1950 sales volumes. Sales of household textiles, infants' wear, women's and children's shoes, and men's furnishings in 1951 were also moderately higher than they were in 1950.

Changes in Department Store Sales and Stocks by Selected Types of Merchandise, Second Federal Reserve District, 1950-51
(Percentage change in total sales from 1950 to 1951; in stocks from December 31, 1950 to December 31, 1951)



Except for stocks of women's suits, the dollar volume of year-end inventories of the nondurables shown in the accompanying chart were higher than on December 31, 1950. This probably reflects some overoptimism on the part of retailers concerning the strength of the demand for these goods during the fall and winter seasons. The year-end values of inventories of the major durable lines, despite their lower levels on December 31, 1951, compared less favorably in terms of year-to-year stocks-sales relationships than did many of the more important nondurable lines. Moreover, some of the reduction in the stocks of durables, particularly household appliances and

**Indexes of Department Store Sales and Stocks
Second Federal Reserve District**
(1947-49 average=100 per cent)

Item	1952	1951		
	Jan.	Dec.	Nov.	Jan.
Sales (average daily), unadjusted.....	80	179	131	96
Sales (average daily), seasonally adjusted..	100	103	104	120
Stocks, unadjusted.....	101	106	132	106 ^r
Stocks, seasonally adjusted.....	114	115	115	120 ^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 Jan. 31, 1952
	Jan. 1952	Jan. through Dec. 1951	
Department stores, Second District.....	- 16	+ 5	- 5
New York City.....	- 18	+ 4	- 5
Nassau County.....	- 16	+ 13	+ 4
Northern New Jersey.....	- 17	+ 5	- 9
Newark.....	- 17	+ 4	- 10
Westchester County.....	- 5	+ 13	+ 6
Fairfield County.....	- 6	+ 5	+ 4
Bridgeport.....	- 6	+ 6	-
Lower Hudson River Valley.....	- 16	- 1	- 10
Poughkeepsie.....	- 15	0	- 7
Upper Hudson River Valley.....	- 11	+ 6	- 6
Albany.....	- 19	+ 5	- 9
Schenectady.....	+ 1	+ 6	- 6
Central New York State.....	- 18	+ 6	- 2
Mohawk River Valley.....	- 15	+ 2	- 11
Utica.....	- 8	+ 3	- 11
Syracuse.....	- 20	+ 8	+ 2
Northern New York State.....	- 49	+ 4	- 29
Southern New York State.....	- 11	+ 6	0
Binghamton.....	- 11	+ 5	0
Elmira.....	- 12	+ 7	0
Western New York State.....	- 11	+ 6	- 2
Buffalo.....	- 8	+ 5	- 4
Niagara Falls.....	- 7	+ 6	-
Rochester.....	- 15	+ 6	+ 3
Apparel stores (chiefly New York City).....	- 8	0	- 3

television, undoubtedly reflects revaluation at lower prices, although the largest part is probably the result of the drastic cuts in orders for additional merchandise initiated earlier in the year.

NATIONAL SUMMARY OF BUSINESS CONDITIONS

(Summarized by the Board of Governors of the Federal Reserve System, February 29, 1952)

Industrial and construction activity and retail sales continued to change little in January and February. The average level of wholesale prices decreased reflecting marked declines in basic commodities. Bank loans were reduced owing mainly to decreases in loans for nondefense business purposes.

INDUSTRIAL PRODUCTION

Output at factories and mines in January, as measured by the Board's seasonally adjusted index, was 219 per cent of the 1935-39 average—little changed from the level of recent months and slightly below a year ago. Durable goods production was maintained at a level 5 per cent higher than a year ago, while output of nondurable goods continued about 6 per cent below the early 1951 record rate.

Activity in most munitions and producers' equipment lines showed little change in January after increasing steadily in other recent months. Passenger auto assembly was curtailed further owing in large part to additional model change-overs, but showed a substantial rise in February. Production of household durable goods rose somewhat in January reflecting increased television output. Nonferrous metals production rose further to a new postwar high owing mainly to expansion of aluminum capacity and output. Steel production changed little from December to January and in February was scheduled at a new record rate.

Nondurable goods output in January was at about the October-November rate after a slight dip in December. Changes in the index of nondurable goods production over this period reflected mainly fluctuations in the textile, leather, and paper industries. Petroleum refining and output of chemicals and rubber products were maintained in large volume.

Meat production in January was close to year-ago levels. During the first three weeks of February output of pork showed much less than the usual seasonal decline and was substantially larger than a year earlier.

EMPLOYMENT

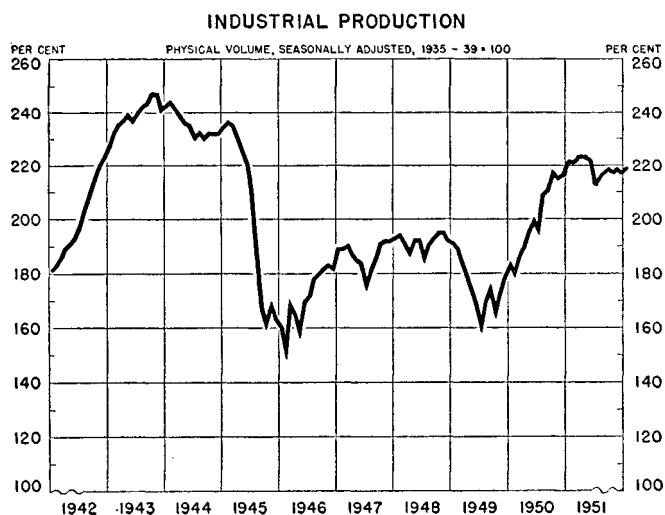
Employment in nonagricultural industries, after adjustment for seasonal variation, continued in January at 46.5 million. Average weekly hours of work at factories, which rose considerably in December, declined again to a level only slightly above other recent months, while average hourly earnings changed little. Unemployment was reported at 2.1 million in early January, up 400,000 from the preceding month, owing mainly to seasonal curtailment of construction and other outdoor activities, but 450,000 below a year ago.

CONSTRUCTION

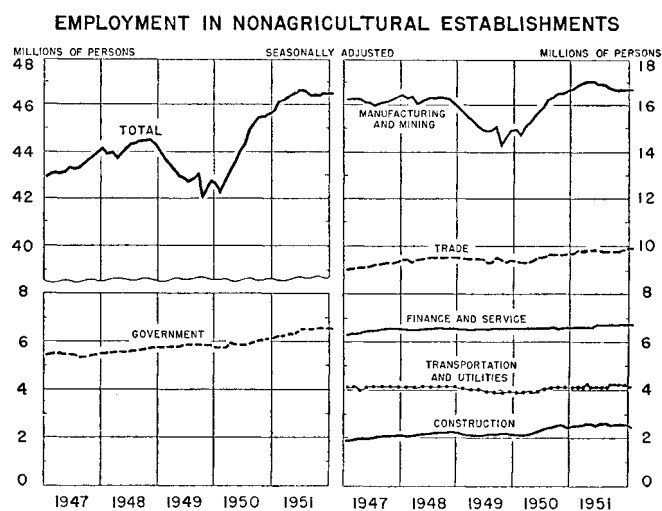
Value of construction contract awards in January was somewhat smaller than in other recent months, despite a slight increase in public works and utilities and a sustained volume of industrial awards, and was substantially below the year-ago total. January housing starts totaled 68,000, as compared with 62,000 in December and with 86,000 a year ago.

DISTRIBUTION

Seasonally adjusted sales at department stores in January and the first half of February remained close to the December level. Retail sales of durable goods, seasonally adjusted, in January were generally above the reduced December level. Stocks held by department stores at the end of January were estimated to be little changed from December. Stocks of men's



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



Bureau of Labor Statistics data adjusted for seasonal variation by Federal Reserve. Proprietors and domestic servants are not included. Midmonth figures; latest shown are for January.

clothing and of some consumer durables remained somewhat high in relation to sales of these items.

COMMODITY PRICES

The general level of wholesale prices declined moderately in February, reflecting continued weakness in the markets for basic commodities. The most marked declines were in prices of textiles and other materials used by the nondurable goods industries, but prices of scrap metals also eased. Livestock prices weakened further and were considerably below the peak year-ago levels as marketings, particularly of hogs, showed a much less than seasonal decrease. Wholesale prices of most metal products, on the other hand, continued at ceilings.

The consumers' price index was unchanged in January as further declines in prices of apparel and housefurnishings were offset by increases in rents and miscellaneous services. Since mid-January retail prices of foods have shown some declines, while prices of passenger automobiles have been raised.

MONEY AND BANK CREDIT

Total loans at banks declined in January and early February owing largely to a decrease in loans to business. Loans for

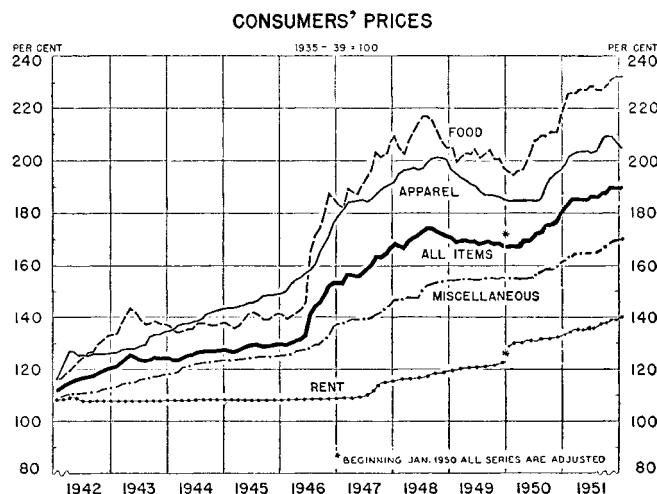
commodity transactions and most other nondefense business purposes were sharply reduced, while loans for defense and defense-supporting activities continued to increase substantially.

Member bank reserve positions were easy during most of January but tightened somewhat near month end and in the first three weeks of February. A post-Christmas return flow of currency and a further gold inflow supplied reserves to member banks, while an increase in Treasury deposits at the Reserve Banks and a substantial reduction in Federal Reserve holdings of Government securities absorbed reserves.

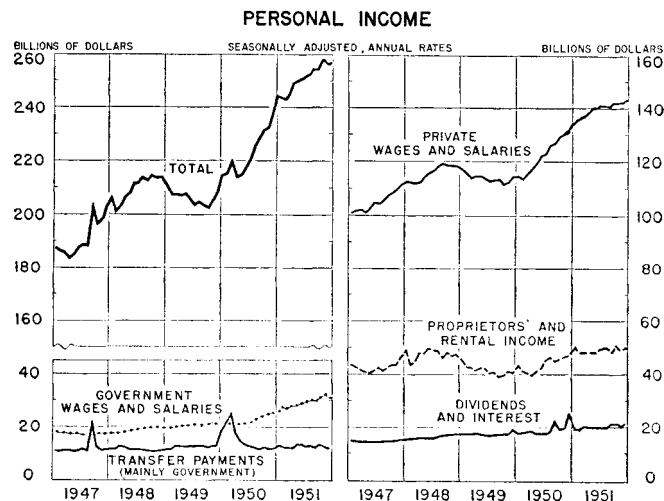
SECURITY MARKETS

Common stock prices declined moderately during the first two weeks of February and dropped more sharply during the third week.

Yields on short-term Government securities declined slightly during the first three weeks of February, while yields on intermediate-term issues rose somewhat in anticipation of an increase in the supply of securities to be made available to this sector of the market through the Treasury offering of new issues announced on February 13.



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



Department of Commerce estimates. Wage and salary data shown are disbursements and include employee contributions for social insurance which are excluded from the total. Monthly figures, latest shown are for December.