MONTHLY REVIEW

Of Credit and Business Conditions

FEDERAL RESERVE BANK OF NEW YORK

VOLUME 36 | SEPTEMBER 1954 | No. 9

MONEY MARKET IN AUGUST

Excess reserves held by member banks during the month of August averaged 930 million dollars, and free reserves more than 800 million dollars, the highest levels since January. The bulk of these reserves, however, was held by the "country" banks, and reserve positions of banks in the principal money centers, New York and Chicago, were under recurrent pressure during most of August. In the early part of the month, the free reserves held by the country banks, and to a lesser extent by reserve city banks, did not appear to be moving into use at the money centers as quickly as might have been expected. As the month progressed, however, banks and security dealers in the central money markets aggressively sought funds in all sections of the country, Treasury bill yields rose, rates for Federal funds held close to the Reserve Bank discount rate, and reserves began gradually to be drawn toward the central money markets. Bank credit for business and other borrowers continued to be readily available throughout the month both at the country banks and banks in the money centers.

The accumulation of reserves in the hands of the country banks during August was the result of several different factors. The large city banks invested the free reserves that they acquired as a result of the reductions in member bank reserve requirements on July 29 and August 1 either in advance or very shortly after they received them, but many of the country banks tended to hold their newly freed reserves idle, possibly in anticipation of a seasonal pick-up in loan demands. Also, a major shift of funds from city banks to country banks occurred early in the month as a result of Treasury operations. At the beginning of August the Treasury paid out an aggregate of about 1.9 billion dollars to redeem both maturing Commodity Credit Corporation (CCC) crop loans and regular and special certificates of interest. Most of these loans and certificates were held by the country banks, but a large part of the funds used to make the payments were drawn from the city banks, through withdrawals from Tax and Loan Accounts in the larger depositary banks and through the sale on August 2 of new tax anticipation certificates, which were particularly attractive to the larger banks and corporations. Part (25 per cent) of the payments for these certificates had to be made in cash.

Since member bank free reserves in the aggregate were substantial and since the reductions in reserve requirements that occurred the week ended August 4 released funds in advance of the banks' actual needs, the System Open Market Account (as it had in July) absorbed the greater part of these newly freed reserves through the sale or redemption of Treasury bills during the first three weeks of August. The initial impact of these sales or redemptions fell on the central reserve city banks, thus increasing the temporary pressures on their reserve positions. Government security dealers also experienced some difficulty from time to time in financing their security portfolios. As funds flowed into New York and Chicago from the outlying areas only gradually over the month, the Federal Reserve Bank of New York from time to time provided the money market with some temporary assistance through repurchase agreements with dealers. On occasion, nevertheless, the central reserve city banks were still short of reserves and had to make up cumulative deficits by borrowing from the Reserve Banks toward the end of statement weeks.

As a result of the relative shortage of funds in the central money markets during August, short-term money rates in general firmed. Quotations on Federal funds soon rose from the nominal levels prevailing at the beginning of the month to levels close to the Reserve Bank discount rate, and bank rates on dealer loans climbed from 1 per cent to as high as 1⅝ per cent. Average issuing rates on new issues of Treasury bills rose from 0.800 on July 29 to 0.983 per cent for the issue dated August 26, the highest level since April 22. Rates on outstand-

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ing bill issues also were higher, and prices of intermediate and long-term bonds moved somewhat lower toward the close of the month. Rates on commercial paper, however, were reduced at the beginning of the second week in August for the sixth time this year, declining from a quotation of 1⅜ per cent on prime 4-to-6 month paper to a range of 1¼-1⅜ per cent.

The Treasury's refunding offer for the 7.5 billion dollars of August 15 and September 15 certificates of indebtedness, which was announced at the end of July, was well received in the market; 3,808 million dollars of the maturing certificates were exchanged for the new 2⅛ per cent bonds of November 1960 and 3,558 million for the 1⅛ per cent certificates of August 1955, leaving only 145 million to be redeemed for cash. On August 12 the Treasury also announced a call for redemption on December 15 of the 510 million dollars of 2 per cent bonds of December 1951-55.

Changes in bank loans and investments in August reflected primarily the retirement of the CCC obligations and the sale of the March 22, 1955 tax anticipation certificates, a large part of which was bought initially by the banks. Approximately 2.0 billion dollars of the new certificates were allotted to banks and 1.7 billion to nonbank subscribers. There was less evidence than usual of a seasonal upswing in the demand for commercial loans during August.

Member Bank Reserve Positions

The operations of the regular market factors had little net effect on member bank reserve positions in the aggregate during August. Week-to-week fluctuations in reserve balances stemming from these factors were moderate, and for the four statement weeks ended August 25 changes in these factors absorbed only a minor amount of funds. Float expanded somewhat, but this gain, as Table I indicates, was offset by small losses arising from an increase in Treasury deposits with the Reserve Banks, foreign account operations, a decline in the gold stock, and a rise in the demand for currency.

Table I
Weekly Changes in Factors Tending to Increase or Decrease Member Bank Reserves, August 1954
(In millions of dollars; (+) denotes increase, (—) decrease in excess reserves)

Factor	Statement weeks ended August 4	August 11	August 18	August 25	Four weeks ended August 25
Operating transactions					
Treasury operations*	−125	+ 94	− 66	+ 51	− 46
Federal Reserve float	+ 84	− 55	+212	−129	+112
Currency in circulation	−117	− 18	+ 45	+ 80	− 10
Gold and foreign account	+ 25	− 84	+ 11	− 14	− 62
Other deposits, etc	− 26	+ 43	− 63	+ 11	− 35
Total	−161	− 18	+140	− 2	− 41
Direct Federal Reserve credit transactions					
Government securities					
Direct market purchases or sales	−192	−302	−147	− 52	−693
Held under repurchase agreements	—	—	+ 80	+ 4	+ 84
Loans, discounts, and advances	− 50	+318	− 28	−147	+ 93
Total	−242	+ 16	− 95	−195	−516
Total reserves	−403	− 2	+ 45	−197	−557
Effect of change in required reserves†	+697	+ 80	+ 19	+ 9	+805
Excess reserves†	+294	+ 78	+ 64	−188	+248
Daily average level of member bank:					
Borrowings from Reserve Banks	71	182	139	88	120
Excess reserves†	1,055	959	942	771	932

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

The principal changes in member bank reserve positions during the month resulted from the one percentage point reduction in the reserves that member banks are required to maintain against their demand deposits and from the reduction in the Treasury bill holdings of the System Open Market Account. While these two factors were partially offsetting when the figures for the month as a whole are considered, they had a marked effect on bank reserve positions because of differences in their timing. The reserve requirement reduction took effect for the central reserve and reserve city banks on July 29 and for the country banks on August 1. More than 900 million dollars of reserves were freed by the reduction. Although part of these reserves was immediately absorbed by the increase in deposits resulting from bank purchases of the new tax anticipation certificates, or from a rise in loans to or securities purchased from their customers who subscribed to the tax certificates, there was still 700 million dollars remaining as additional free reserves on the August 4 statement date. Smaller declines also occurred later in the month, bringing the total net reduction for the four weeks to about 800 million. The System Open Market Account security operations, and changes in repurchase agreements made with Government security dealers by the Federal Reserve Bank of New York, in contrast, were spaced throughout the month, and amounted on net balance to a total of 609 million dollars for the four weeks ended August 25. In the first week of August the average amount of free reserves held by member banks rose to nearly 1,000 million from an average of 600 million in the preceding week. While the average dropped back to about 700 million by the final statement week of the month, free reserves averaged about 800 million dollars for the four statement weeks ended August 25.

The experience of banks in New York City and to a lesser extent those in Chicago in these four weeks, however, was sharply different from that of banks in other parts of the country. Their reserves were chronically short, and their efforts to find reserves contributed to a firm tone in the money market. The Treasury, for the reasons outlined earlier, withdrew approximately 400 million dollars from New York City during the four weeks ended August 25. In addition, the City banks and their customers were awarded 524 million dollars more of the new weekly issues of Treasury bills than they held of the maturing ones (dated July 29 and August 5, 12, and 19), reflecting in part the fact that the System Open Market Account was allowing its maturing bills to run off, which meant reserve losses of a like amount. They also suffered minor losses during the month from the increase in the demand for currency. The decline in the City banks' required reserves during August provided only a minor offset to these losses.

The net flow of funds to New York arising from transactions such as purchases of Federal funds and transfers of uninvested funds to the City by correspondent banks and others during the four weeks ended August 25 largely offset the City banks' losses from Treasury operations and other factors. An aggregate analysis, however, conceals the intraweekly distribution of market gains and losses, and it was the distribution that created many of the banks' reserve difficulties. Funds flowed out of New York on balance every Thursday during August (partly because of the repayment of funds borrowed during the previous statement week from banks in other parts of the country). These losses, added to those resulting from weekly Treasury bill sales, resulted in central reserve banks carrying reserve deficiencies over the week end. Even though funds flowed back to the City in larger volume in the latter part of each statement week, and the Federal Reserve Bank of New York on occasion put moderate amounts of funds into the market through repurchase agreements with Government security dealers, some of the large banks frequently found it necessary to borrow from the Reserve Bank at the end of the statement week to meet their average reserve requirements. These advances were generally repaid at the beginning of the following week. (This explains why Federal Reserve discounts and advances were at fairly high levels on Wednesdays, the statement dates, and yet the average amount outstanding for the week as a whole was small.)

The Market for Government Securities

The volume of activity in the Government securities market was relatively light again in August, and prices were somewhat easier, reflecting not only a lack of buying interest and the usual summer vacation lull, but also in increasing degree the firmness of the New York and Chicago money markets. Trading interest, particularly in the early part of the month, centered in the August-September "rights" (before the books were closed on August 5 on the Treasury's exchange offering) and in the three securities issued in August, the 1⅛ per cent certificates of August 1955, the 2⅛ per cent bonds of November 1960, and the 1 per cent tax anticipation certificates of March 22, 1955.

The refunding offer for the August and September certificates was announced on Friday, July 30. When the market opened on Monday, August 2, fairly brisk trading developed in the "rights" and subsequently in the new issues on a "when-issued" basis. Dealers' bids on the August and September certificates which had closed on July 30 at $100^{25}/_{64}$ and $100^{29}/_{64}$, respectively, moved up to highs of $100^{18}/_{32}$ and $100^{19}/_{32}$. On a "when-issued" basis, prices of the 2⅛ per cent bonds opened at $100^{12}/_{32}$ and moved up to $100^{19}/_{32}$; they declined fractionally in the latter part of the month to close on August 27 at $100^{17}/_{32}$. The new certificates opened at an $^{11}/_{32}$ premium and remained at or close to this level during most of the month, but closed on August 27 at $100^{9}/_{32}$ (bid).

Trading in the bill market was generally light in August. The relatively tight reserve position of the New York and Chicago banks and the resulting rise in the rates for funds had a depressing effect on both prices and trading activity, and bills were generally in supply in the market. Some of the larger banks liquidated part of their bills in an effort to build up their reserves and, as noted earlier, the System Open Market Account reduced its bill holdings. Corporations and banks that had funds available for short-term investment in August were in general more interested in certificates, particularly the new tax anticipation issue, and short notes or bonds, than in bills; those that did want bills frequently purchased the new issues on direct tender. The fact that the refunding offer was so successful also meant that few investors sold their "rights" and put the money into bills pending more permanent investment as they sometimes do. The average issuing rate for the new bills dated August 5 declined fractionally to 0.797 per cent from the 0.800 per cent average for the July 29 bills, but each succeeding issue in August was awarded at a higher average rate—0.892, 0.898, and 0.983 per cent, respectively. Rates on outstanding bill issues also rose, with those on the shortest issues reaching a high of 1.50 per cent on the bid side in the middle of the month. At the close of the market on August 27, dealers' posted bids for bills ranged from 1.20 per cent for the shortest issue, to 1.00 per cent for the longest bills; at the end of July the range had been 0.60—0.79 per cent.

Prices of all certificates except the new 1⅛ per cent issue declined moderately. The new tax anticipation issue, which had opened on July 22 at a $^{2}/_{32}$ premium, declined to $99^{63}/_{64}$ (bid) by August 23. Most short-term bonds and notes were off from $^{2}/_{32}$ to $^{8}/_{32}$ of a point for the month. Prices of intermediate and long-term bonds declined early in August, partly because of the lack of any substantial buying interest and partly as a reflection of the money market developments. They picked up again in the middle of the month, and then fluctuated irregularly. The exchanges for the 2⅛ per cent bonds were higher than the market had anticipated and prices reacted downward temporarily. Toward the end of the final week of August dealers marked prices of long-term issues down again, largely in response to a decline in prices of public utility bonds. This price decline was due to a growing volume of prospective new financing. Over the four weeks ended August 27 prices of intermediate and long-term Government bonds generally were off ⅛ to ⅝ of a point.

Switching operations were again the principal feature of the bond market. A number of banks made portfolio adjustments, usually with the intention of lengthening their average maturity, and some of the original purchasers of the 2½ per cent bonds of November 1961 that were issued last February shifted out of the bonds into other, often neighboring, issues in order to realize capital gains.

Member Bank Credit

Total loans and investments of the weekly reporting member banks rose 1,750 million dollars during the four weeks ended August 18. The largest part of this increase, approximately 1.6 billion dollars, represented allotments of the new tax anticipation certificates. In addition, these banks purchased fairly substantial amounts of Treasury bills (553 million) and a small amount of other securities, bringing the total increase in their security portfolios for the four weeks to 2,212 million. Figures for the statement week ended August 18 appear to indicate that the weekly reporting banks exchanged roughly 1.6 billion dollars of their holdings of August and September certificates for the new 2⅛ per cent bonds of November 1960. Total loans, on the other hand, declined 462 million, reflecting for the most part another phase of the Treasury's operations, the retirement of maturing CCC crop loans and certificates of interest. Net changes in other commercial, industrial, and agricultural loans and other types of credits, as Table II indicates, were more moderate.

Changes in bank assets and liabilities during the past two years are shown in Tables III and IV; these figures indicate quite clearly the effects on the banking system of the shift in the economy from a period of threatened inflation to one of mild deflation and the accompanying shifts in Federal Reserve credit policy. As may be noted, the increase in assets and liabilities in the year ended June 30, 1954 was nearly two and one half times as great as in the preceding year. Also, on the asset side of the balance sheet, the total increase in loans was substantially smaller this past year than in the preceding one, 2.2 billion dollars against 5.8 billion, while investments rose 6.2 billion this year and declined 2.3 billion last year. As Table III also indicates, the rise in investments occurred almost entirely at the large city banks, and the total change in loans and investments at commercial banks outside of the central reserve and reserve cities was similar in both years.

On the liability side, practically the only increase in deposits for all commercial banks combined in the year ended June 1953 was in time deposits, principally those of individuals, partnerships, and corporations. But this past year, while time deposits continued to grow, demand accounts increased as much as time, and interbank deposits also experienced a substantial net expansion. Again the changes were concentrated in the large banks. Outside the central reserve and reserve cities, the increases in deposits were almost exactly the same in both years except that interbank deposits showed a modest net increase this year against a small decline last year. In the larger cities in the year ended June 30, 1954, demand deposits were up nearly 2 billion dollars, compared with a decline of approximately 1¼ billion last year, and interbank deposits increased by 1.6 billion; in the preceding year there was almost no net change. One half of this recent 1.6 billion increase was in interbank time deposits on the books of the New York City banks, principally those held for foreign banks.

Table II
Weekly Changes in Principal Assets and Liabilities of the Weekly Reporting Member Banks
(In millions of dollars)

Item	Statement weeks ended: July 28	August 4	August 11	August 18	Change from Dec. 30, 1953 to August 18, 1954
Assets					
Loans and investments:					
Loans:*					
Commercial, industrial, and agricultural loans	− 34	− 754	+ 59	− 70	−2,621
Security loans	− 61	+ 372	+ 74	−111	+ 99
Real estate loans	+ 13	+ 18	+ 30	+ 35	+ 320
Loans to banks	+173	− 1	−151	− 91	− 190
All other loans (largely consumer)	− 3	+ 16	+ 3	+ 25	− 188
Total loans, net*	+ 86	− 350	+ 16	−214	−2,615
Investments:					
U.S. Government securities:					
Treasury bills	+184	+ 683	−150	−164	+ 845
Other	+ 19	+1,701	− 66	− 40	+2,540
Total	+203	+2,384	−216	−204	+3,385
Other securities	+ 45	+ 69	− 81	+ 12	+ 789
Total investments	+248	+2,453	−297	−192	+4,174
Total loans and investments	+334	+2,103	−281	−406	+1,559
Loans, net, and "other" securities	+131	− 281	− 65	−202	−1,826
Liabilities					
Demand deposits, adjusted	+468	− 732	− 90	−379	−2,469
Time deposits except Government	+ 44	+ 51	+ 2	—	+1,681
U. S. Government deposits	−245	+1,601	−268	+275	+1,102
Interbank demand deposits:					
Domestic	−420	+ 978	−133	−246	− 453
Foreign	+ 94	− 10	− 20	− 1	+ 32

* Figures for various loan items are shown gross (i.e., before deduction of valuation reserves); they therefore may not add to the total, which is shown net.

Table III
Changes in the Total Loans and Investments of All Commercial Banks Twelve Months Ended June 1953 and June 1954
(In billions of dollars)

Class of bank	Loans 1953	Loans 1954p	Investments 1953	Investments 1954p	Total 1953	Total 1954p
Central reserve city banks	+0.8	−0.2	−2.1	+2.8	−1.3	+2.6
Reserve city banks	+2.4	+0.3	−1.1	+2.4	+1.3	+2.7
All other banks	+2.6	+2.1	+1.0	+0.9	+3.6	+3.1
All commercial banks	+5.8	+2.2	−2.3	+6.2	+3.5	+8.4

Note: Because of rounding, the figures do not necessarily add to the totals shown.
p Preliminary.

Table IV
Changes in Total Deposits of All Commercial Banks Twelve Months Ended June 1953 and 1954
(In billions of dollars)

Class of bank	Demand 1953	Demand 1954p	Time 1953	Time 1954p	Interbank 1953	Interbank 1954p	Total 1953	Total 1954p
Central reserve city banks	−1.6	+0.9	+0.2	+0.4	− *	+1.0	−1.4	+2.3
Reserve city banks	+0.3	+1.0	+1.0	+1.2	+0.2	+0.6	+1.4	+2.8
All other banks	+1.4	+1.5	+1.8	+1.8	− *	+0.3	+3.2	+3.5
All commercial banks	+0.1	+3.4	+3.0	+3.4	+0.1	+1.9	+3.2	+8.6

Note: Because of rounding, the figures do not necessarily add to the totals shown.
p Preliminary.
* Less than 50 million dollars.

THE EUROPEAN PAYMENTS UNION TODAY

The European Payments Union, which entered its fifth year on July 1, has gone a long way toward realizing the aims of its founders. The EPU has helped expand trade and payments among its member countries and their associated areas, and has facilitated progress toward general currency convertibility and nondiscriminatory trade. A return to convertibility by the major countries of Western Europe is now closer to attainment than at any time since the war. There is now general expectation that a group of these countries will seek to re-establish convertibility more or less simultaneously and that the EPU would then cease functioning. The very terms of the recent agreement prolonging the EPU for another year reflect this advance toward a wider payments system. As a result of this agreement, the gradual repayment of debts that have accumulated within the EPU has already begun, thus helping to clear the way for the EPU's liquidation in the event that some of its members restore convertibility.

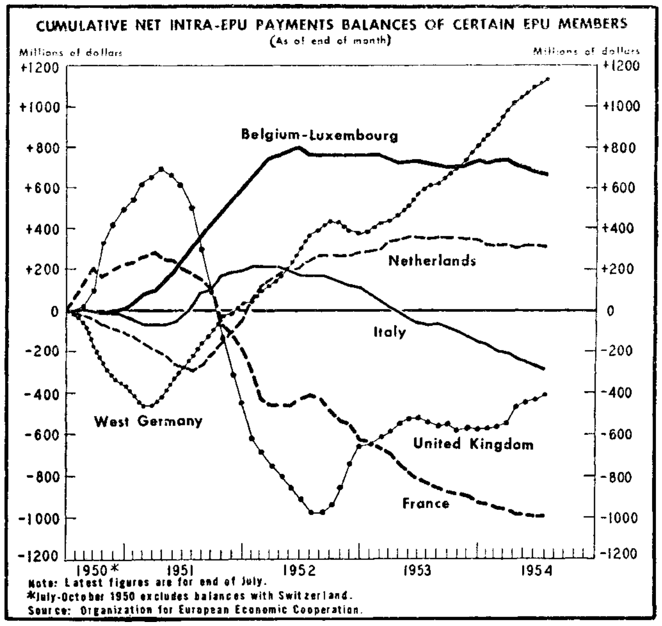
The Accomplishments to Date

When the EPU was established in mid-1950, Western European trade was still suffering from the rigid bilateral trading that the earlier intra-European payments schemes had failed to correct. To remedy this unsatisfactory situation, it will be recalled, a concerted three-pronged approach was devised. First, the EPU itself was created to operate a clearing system for intra-European payments and to provide credits for the settlement of a part of the resulting net balances, the remainder to be settled in gold according to an agreed scale.[1] In addition, the member countries developed a program for the gradual freeing of intra-European trade from quota restrictions. Finally, these countries adopted a procedure for continuing consultation and discussion in order to bring about a better mutual understanding of their internal economic and financial problems and policies and thus promote cooperation in matters of common interest.

Even though no exact measurement of the EPU's contribution to the economic recovery of Western Europe is possible, it is noteworthy that the volume of intra-European trade is now about twice as great as in 1948 and some 50 per cent higher than before the war. In the absence of clearing and credit facilities, such as the EPU provided, and of the accompanying reduction of trade restrictions, it is highly doubtful that an increase of this magnitude would have occurred. The clearing facilities relieved the EPU nations of the necessity to maintain a strict bilateral balancing of their trade with each other, and thus made possible the ending of intra-European trade discrimination. The provision of credit under the EPU arrangements enabled the member countries to relax the restrictions on their mutual trade in the knowledge that any moderate temporary deficits that might result would not seriously deplete their gold and dollar reserves, which were very low at the time the EPU was established.

The intra-European trade liberalization program was an essential accompaniment of the EPU's payments facilities. Progress in the removal of quantitative restrictions on intra-European imports, even though not without temporary setbacks, has been considerable. By July 1, 1954, 80 per cent of nongovernmental intra-European imports were free of quota restrictions, compared with 56 per cent four years earlier. As a result of this removal of artificial barriers, intra-European trade now flows along more natural, economic channels to the substantial benefit of all member countries.

Also of considerable importance have been the regular, and special emergency, credits provided by the EPU to countries experiencing temporary difficulties. Such EPU credit assistance



served to give these countries a breathing space during which remedial measures could take effect. Furthermore, when countries were forced to retreat temporarily from trade liberalization, the cooperative attitude of the remaining member countries enabled them to do so without reprisals.

Individual Country Positions

Developments in the EPU positions of individual member countries to date serve to point up some of the broader aspects of the EPU's operations. The importance of adequate liquid reserves to cushion the ups and downs in international payments, both of the more normal kind and of the rather abnormal type such as followed the Korean outbreak, is well illustrated by the United Kingdom's EPU experience. The United Kingdom's EPU position, which reflects the payments with the EPU area of the whole sterling area (except Iceland), has undergone the widest swings of all EPU members (see chart). While these swings have not been large relative to the total transactions involved, without the EPU's facilities they would have put a very great strain on the United Kingdom's reserves. During the sixteen months beginning in May 1951, for example, the United Kingdom ran EPU deficits of 1.7 billion dollars, equal to almost one half of the British gold and dollar reserves at the time these deficits began. Thanks to the EPU's credit arrangements, the resulting drain on British reserves was held to 700 million dollars. But the United Kingdom's EPU experience also shows that even a large provision of secondary reserves may not be sufficient by itself to avoid the reimposition of restrictions in case of temporary difficulties. It was only the restoration of better internal equilibrium in the sterling area countries that helped to bring sterling payments with the EPU area into closer balance and made possible a renewed relaxation of restrictions.

West Germany's EPU payments illustrate the problems presented by a large over-all creditor in any payments system,

[1] The organization and earlier operations of the EPU were described in the September 1950, September 1951, August 1952, and August 1953 issues of this *Review*.

whether regional or world-wide. The continuation of large West German surpluses has been a dominant feature of the EPU's operations since the spring of 1951. The country's credit facilities under its quota had been fully utilized by May 1953, and the financing of the subsequent surpluses required special arrangements that provided for 50:50 gold/credit settlements. The continuing credit extension that this involved was not very satisfactory from West Germany's viewpoint. On the other hand, West Germany also had surpluses with the rest of the world, and accordingly the case for the full settlement in gold of its excessive surpluses in the EPU was weakened. West Germany's payments surpluses have been the result of a swift increase in exports, which more than doubled between 1950 and 1953, accompanied by a much slower rise in imports which, in terms of its national product, remain relatively low compared with other Western European countries. An OEEC committee, after studying the problem, has accordingly stressed the need for a policy of internal expansion and more liberal importing, notwithstanding the fact that West Germany's liberalization of imports from EPU members is already high.

Italy's EPU experience reveals the results of the changes in trade patterns that followed from the liberalization of intra-European trade. During 1951-52 Italy was one of the EPU's leading creditors, but its position was reversed in 1952, and by the end of the EPU's fourth year the country had become one of the large debtors. Italy removed quota restrictions on its imports from the EPU area to a greater extent than any other country, and its imports from that area more than doubled after 1950. This increase reduced its dollar-import requirements and its imports from the dollar area accordingly diminished, especially since restrictions on dollar imports were continued; as a result, a substantial improvement in Italy's payments balance with the dollar area was made possible.

Austria's EPU position shows how dramatically a country's international payments position can change within a short space of time. In the first years of the EPU, Austria was one of the "chronic debtors", which required special assistance and were permitted to maintain severe import restrictions. However, once the preconditions for monetary stabilization were created by assistance from abroad and basic economic recovery at home, the adoption of a stringent anti-inflationary policy by the Austrian Government in early 1952 proved very effective and the country began to register surpluses. These surpluses have continued without interruption, following the devaluation of Austria's currency in May 1953. As its situation improved, Austria was able to make considerable progress in removing quota restrictions on its imports from the EPU area.

The Four Years of EPU Operations

A review of the operational experience of the EPU not only serves to highlight some of the general developments during its first four years, but also may help to make clear some of the problems involved in the latest EPU renewal. The total transactions of the member countries with each other during the EPU's first four years may be estimated at well over 150 billion dollars. As a result of these transactions, gross bilateral deficits and surpluses totaling 24.3 billion dollars were reported to the EPU, of which 18.1 billion was offset by EPU clearings. Of the net balances that remained, extensions of credit by the

European Payments Union Operations and New Positions of Member Countries
(In millions of dollars)

Member countries and monetary areas	EPU operations—July 1950-June 1954					The EPU under the 1954 renewal, as of July 1, 1954			
			Cumulative accounting positions			Cumulative accounting positions after special debt repayments		Available settlement facilities for new surpluses by creditors and deficits by debtors	
				Settled by					
	Cumulative net payments surpluses and deficits*	Special settlements independent of quotas	Cumulative surpluses and deficits†	Credit granted (+) or received (−) by member	Gold received (+) or paid (−) by member	Cumulative surpluses and deficits	Credit granted (+) or received (−) by member	Total	To be settled by credits‡
Austria	+ 6.5	+125.0	+ 131.6	+ 72.8	+ 58.8	+ 116.6	+ 58.3	+ 78.0	+ 39.0
Belgium-Luxembourg	+ 678.5	−316.5	+ 362.0	+ 217.0	+ 145.0	+ 297.0	+ 148.5	+ 432.0	+216.0
Denmark	− 135.6	− 5.0	− 140.6	− 97.6	− 43.0	− 175.7	− 87.9	− 88.4	− 44.2
France	− 991.3	+101.9	− 889.4	− 312.0	− 577.4	− 508.0§	− 254.0	− 161.6	− 80.8
West Germany	+1,095.7	+ 11.9	+1,107.6	+ 603.8	+ 503.8	+ 925.6	+ 462.8	+ 600.0	+300.0
Greece#	− 291.5	+268.8	− 22.6	—	− 22.6	− 22.6	—	—	—
Iceland	− 22.4	+ 15.2	− 7.3	− 5.6	− 1.7	− 11.1	− 5.6	− 6.8	− 3.4
Italy	− 265.8	+ 63.0	− 202.8	− 122.3	− 80.5	− 166.7	− 83.3	− 243.4	−121.7
Netherlands	+ 312.4	+ 30.0	+ 342.4	+ 206.7	+ 135.7	+ 328.9	+ 164.4	+ 266.6	+133.3
Norway	− 182.9	+ 60.4	− 122.4	− 89.2	− 33.2	− 152.9	− 76.5	− 102.0	− 51.0
Portugal	+ 48.2	− 3.0	+ 45.2	+ 29.6	+ 15.6	+ 40.2	+ 20.1	+ 78.8	+ 39.4
Sweden	+ 151.6	+ 5.8	+ 157.4	+ 104.7	+ 52.7	+ 146.4	+ 73.2	+ 296.6	+148.3
Switzerland**	+ 335.6	− 22.9	+ 312.7	+ 181.4	+ 131.4	+ 280.7	+ 140.4	+ 240.0	+120.0
Turkey	− 307.7	+ 92.0	− 215.7	− 30.0	− 185.7	− 225.7	− 30.0	—	—
United Kingdom	− 430.8	−243.1	− 674.0	− 485.4	− 188.6	− 773.3	− 386.6	− 576.0	−288.0
Total	+2,628.5	+774.0	+2,458.9	+1,415.9	+1,043.0	+2,135.4	+1,067.7	+1,992.0	+996.0
	−2,628.0	−590.5	−2,274.8	−1,142.1	−1,132.7	−2,036.0	− 923.8	−1,178.2	−589.1

Note: Because of rounding, figures may not add to totals shown.

* Includes interest paid on credits granted or received. The difference between the totals in this column is the amount by which interest paid to creditor members exceeds interest received from debtors.

† Country figures are equal to country cumulative net payments surpluses and deficits after special settlements independent of quotas.

‡ Lending obligations of creditors (+) and borrowing facilities of debtors (−).

§ Not including gold payments (369.4 million dollars) made by France to settle its extraquota deficits before June 30, 1954, which can be recovered by France if it has surpluses.

\# The quota of Greece as a debtor is frozen at zero.

** Switzerland included only from November 1950.

Source: Adapted from data published by the Organization for European Economic Cooperation.

EPU to debtors and by the creditors to the EPU settled 2.6 billion, and net gold payments by and to the EPU settled 2.2 billion (see table).[2] The net gold payments and the net credits required for settling the balances in the EPU thus represented only a very minor portion of the total transactions involved.

This over-all description of the four years of the EPU's operations, however, does not disclose the changes that occurred during this period. The net surpluses or deficits of member countries that remained after the clearings and that had to be settled through the EPU declined sharply in the last two years, compared with the first two years of the EPU. This is a result of the greatly improved equilibrium in payments within the EPU area, which in turn reflects the greater economic stability in the internal conditions of the member countries as well as in the world at large.

The first three years of the EPU witnessed numerous fluctuations in the positions of indvidual countries, some that had deficits in one year earning surpluses in the subsequent year, and vice versa. As a result, a part of the credits previously granted by creditors to the EPU and by the EPU to debtors were repaid, thus helping to reduce the net new extension of such credits in the second and third years of the EPU. In contrast, during the fourth year the debtor or creditor positions of most countries continued to increase, requiring a larger extension of credit than in 1952-53, and leading to an almost complete exhaustion of the remaining credit facilities.

The Renewal of the EPU

The recent agreement renewing the EPU for one year until June 30, 1955 provides for a number of significant changes in the EPU mechanism. The main change is designed to make new credit facilities available on the basis of repayment arrangements for the large debts that resulted from past disequilibria; other changes are aimed at simplifying EPU operations.

In order to reduce the past indebtedness that had accumulated within the EPU, various debtor countries agreed, in voluntary bilateral arrangements with the creditor countries, to special repayments of part of their outstanding debt. In most cases, 25 per cent of the debt subject to these arrangements was to be repaid immediately in gold or dollars (outside the normal EPU settlements), the remainder to be repaid, generally in monthly instalments, over a number of years. Out of the total of 1,142 million dollars of such debts outstanding on June 30, 1954, 858 million was made subject to repayment, of which 224 million was to be repaid immediately. In addition to these bilateral debt settlements, the EPU itself agreed to use its own assets to make gold or dollar repayments to the creditors totaling 130 million dollars.

In consideration of these repayments by the individual debtors and the EPU itself, the creditors agreed to grant new credits to the EPU for the settlement of surpluses from July 1, 1954. Arrangements were made at the same time for reopening credit facilities available to the debtor countries, to the amount of their immediate debt repayments to the creditors; the debtors were also given further credit facilities, basically as a counterpart to the special payments made by the EPU to the creditors.

Among the arrangements made to simplify the EPU mechanism, the most fundamental one was a change in the proportion of gold to credit involved in EPU settlements. The settlement of generally all surpluses and deficits arising after July 1 was put on the basis of 50 per cent gold and 50 per cent credit. This is a considerable change from the earlier arrangements under which the gold/credit ratio varied with a country's position in its quota owing to the provision both of prescribed gold-free credit facilities and of a sliding scale in the gold/credit ratio.

These changes in EPU operations appear, in the words of the EPU Managing Board, "to be particularly appropriate at the present time, and in the new situation that now faces the Union and its Members". The renewal, by setting forth at this time the framework for the gradual repayment of a large part of the debts that have accumulated within the EPU, will facilitate a transition to general currency convertibility and the liquidation of the EPU that would then take place.

The EPU and General Currency Convertibility

The EPU was never intended by its founders to be a permanent institution. Its temporary nature was reiterated this June by the OEEC Council, which stated that the obligations incurred by member countries as the result of the renewal of the EPU would be reconsidered at any time before June 1955, at the request of any member country, "if in the opinion of that Contracting Party this is necessary to enable progress to be made towards a system of freer trade and payments and, in particular, the convertibility of currencies".

Earlier, the OEEC had agreed that member countries should relax, to the fullest extent possible, quantitative restrictions on imports from the dollar area. The reduction of the discrimination against dollar imports currently practiced by most EPU members represents an important aspect of the transition from the limited regional operations of the EPU to a wider payments system based upon convertibility. Further progress in the removal of dollar import restrictions prior to convertibility would go a long way toward moderating the impact of its introduction.

Last May the OEEC Council established a special ministerial group "to examine the different problems which will arise if a number of Member countries re-establish convertibility". The group met in July, with United States representatives as observers, and is scheduled to meet again and to report to the OEEC before November 1. This OEEC ministerial group has already reached agreement in principle on certain essential points, according to official statements made after the July meeting. First, the benefits of intra-European trade liberalization must be preserved; secondly, there is to be a gradual

[2] The remaining net balances totaling 1.4 billion dollars were settled by special arrangements, which included United States grants to several debtor countries to the amount of 367 million.

removal of discrimination against dollar imports; and thirdly, a European fund will be needed at the re-establishment of convertibility, in order to provide credits for present EPU members, so as to help maintain the freest possible flow of trade.

Many questions, however, still remain pending. Among them are the details of the proposed European fund. As regards its resources, the EPU's capital fund, which totals 272 million dollars and was initially provided by the United States, may be used for this purpose and additional contributions may be forthcoming from the EPU countries themselves. The criteria for the granting of credits by such a fund must also be defined; it appears, however, that credits would not be "automatic" as in the EPU.

Conclusion

Today, the principal trading nations and international institutions are giving serious consideration to ways of ensuring an orderly transition from the present form of the EPU to a wider system of trade, payments, and credits. The lessons that may be derived from the EPU experience during the past four years therefore have important implications for future international financial policies. From this experience, broadly outlined in this article, certain major conclusions seem to emerge.

The first is that progress in the payments sphere goes hand in hand with progress in trade. The freeing from quantitative restrictions of trade within Western Europe and its associated monetary areas would have been unattainable without the payments facilities that the EPU has provided the participating nations; but agreement among these nations on commercial policies was also essential if the EPU was to function properly. The success achieved by the EPU thus makes it clear that the adoption and maintenance of currency convertibility calls for further genuine trade liberalization. A system of general currency convertibility can confer its full benefits on the countries concerned, as well as on the world at large, only if it is adopted under conditions that will ensure not merely the preservation of the existing level of trade, but also its gradual expansion.

Another lesson of the EPU experience is that the establishment and maintenance of currency convertibility will be possible under present conditions only if the major trading nations continue to work together. Despite the importance of certain automatic features of a restored convertibility system, many problems will have to be dealt with on an *ad hoc* basis if there is to be a satisfactory functioning of international payments and a sound development of international trade. The means whereby countries might adjust themselves to internal and external disturbances in order to avoid a relapse into currency and trade restrictions have been often reviewed in close formal and informal discussions among responsible authorities of the EPU and the related OEEC bodies. With the restoration of a wider international payments and trade system, there will be continuing need for similar consultations among the authorities about financial and economic problems. It is to be hoped that much of the cooperative spirit that has characterized the EPU will be preserved and will grow in a wider setting when the time comes for the EPU to be liquidated.

The disappearance of the EPU as a clearing mechanism will create no great problem once the EPU's settlement facilities are replaced by general currency convertibility. The multilateral arbitrage linking the exchange markets of nine EPU countries since 1953 is already efficiently accomplishing much of the intra-European clearing that had earlier been handled by the EPU. The EPU has also proved that large transactions among members can be settled with relatively small movements of gold; and the amount of credit that has had to be made available through the EPU has likewise been relatively small. Nevertheless, as heretofore, there will be a continuing need under a restored convertibility system for temporary credits to supplement the member countries' international reserves. The proposed European fund, which would be a source of credits additional to those of the International Monetary Fund, would help fill the void brought about by the EPU's liquidation, so that Western European countries need not revert to trade restrictions.

In the light of the EPU experience, there can be little doubt as to the importance of internal economic stability for international balance and the close connection between internal and external economic policy. On a number of occasions in the past, when the EPU balances of some member countries were getting out of hand, the timely adoption of suitable domestic policies helped to correct the disturbance. However well designed may be the international trade and payments system that will emerge with convertibility, it appears that such a new system, like the European Payments Union, can be successful only if individual countries pursue appropriate policies internally as well as externally.

EARNINGS AND EXPENSES OF SECOND DISTRICT MEMBER BANKS IN THE FIRST SIX MONTHS OF 1954

Net earnings of Second District member banks from current operations in the first six months of 1954 showed a small increase over the first half of 1953, and profits taken on security sales were substantial. Consequently, net profits after taxes increased 37 per cent, reaching an all-time high for a year's first half of 147 million dollars. This increase in the Second District member banks' net profits substantially exceeded the rise—28 per cent—in profits of all member banks in the country, which likewise established a new earnings peak for a year's first half. The relatively greater increase in the profits of Second District banks is entirely attributable to the increase in the net profits of the central reserve New York City banks, which rose by 40 per cent. Outside New York City, the increase in Second District member banks' net profits closely paralleled the rise for all member banks in the country.

Both in the Second District and throughout the country, the principal factor raising member bank net profits in the first half of 1954 above 1953 levels was a change from losses to profits on sales of Government securities. Since May 1953, market prices of Government securities have risen, with only short interruptions, to the highest levels since early 1951. This rise in Government security values has reduced or eliminated whatever unrealized depreciation existed in member bank portfolios and, as the accompanying table shows, has also provided numerous opportunities for banks to establish capital gains through Government security sales.

Capital gains of the District's member banks from security sales were enlarged in the first half of 1954 as a result of the portfolio "switching" operations the banks had undertaken in 1953 to establish deductible capital losses for income tax purposes.[1] (This security "switching" involved the sale at a loss of issues held, and the use of the sale's proceeds to acquire other, comparable issues.) To the extent that losses incurred on sales of securities in 1953 (principally in the second half of the year) exceeded the resulting tax savings, the banks' 1953 profits were reduced by switching operations. But the simultaneous purchase of comparable securities at depressed prices has enabled the banks to derive capital gains from the subsequent rise of security prices. Thus, the net effect of the 1953 security switching by Second District member banks was to depress profits reported in that year but to increase profits thus far in 1954.

[1] See "Earnings and Expenses of the Second District Member Banks", this *Review*, March 1954, p. 44.

Operating Income

The reduction in reserve requirements that occurred in July 1953 permitted the District's member banks to add somewhat to their earning assets. These additions to assets were in turn reflected in a continuation of the increase in the banks' total current earnings that has been in progress for the past fifteen years. The increase in gross earnings of the central reserve New York City banks (5.5 per cent), however, was only half as great as the 11.1 per cent increase shown by the Second District's reserve city and country banks. In large part, this difference in rates of growth in earnings arose from the fact that the year-to-year increase in earning assets of the central reserve city banks was centered in Government securities, on which yields were comparatively low, while in the reserve city and country banks the additional earning assets took the form of loans that provided higher rates of return.

Interest received on U. S. Government securities increased 18 per cent between the first halves of 1953 and 1954 in the central reserve New York City banks, but changed little in the reserve city and country banks. In the City banks, the rise reflected a 20 per cent increase in average holdings of Govern-

Earnings and Expenses of Member Banks in the Second Federal Reserve District for the First Six Months of Selected Years
(In millions of dollars)

Item	New York central reserve city banks				Reserve city and country banks			
	1949	1951	1953	1954	1949	1951	1953	1954
Number of banks	25	22	22	22	752	721	686	666
Earnings:								
On United States Government securities	70.6	63.4	61.5	72.3	37.8	35.0	40.2	40.5
On other securities	11.9	17.7	21.3	23.4	7.4	8.5	10.8	11.8
On loans	94.9	144.6	209.7	211.2	59.5	80.6	104.9	119.7
Service charges on deposit accounts	7.4	8.9	9.7	10.4	8.8	10.5	12.1	14.3
Trust department earnings	26.1	30.3	34.1	37.1	3.3	3.6	4.1	4.6
Other current earnings	23.1	26.4	28.0	29.9	7.8	9.0	9.5	10.2
Total current operating earnings	234.0	291.3	364.3	384.3	124.6	147.2	181.6	201.1
Expenses:								
Salaries and wages—officers and employees	78.9	92.4	107.6	112.7	38.3	45.4	55.0	61.6
Interest on time deposits	3.8	5.8	11.7	20.0	15.7	16.3	23.7	28.6
Interest and discount on borrowed money	0.9	1.4	3.3	1.3	0.2	0.4	0.7	0.2
Taxes other than on net income	4.7	6.7	6.5	7.0	3.7	4.7	5.1	5.6
Recurring depreciation on banking house, furniture and fixtures	1.7	1.9	2.0	2.1	2.4	2.8	3.6	4.2
Other current operating expenses	48.8	53.4	63.5	67.9	26.1	30.6	36.0	39.8
Total current expenses	138.8	161.6	194.6	211.0	86.4	100.2	124.1	140.0
Net current operating earnings before income tax	95.2	129.7	169.7	173.3	38.2	47.0	57.5	61.1
Net recoveries (+) or charge-offs (−) on loans	− 5.2*	+ 1.6	—	− 1.2	− 5.2*	− 3.2	− 1.2	− 1.0
Security profits and recoveries (+) or charge-offs (−)	+ 4.3†	+ 6.0	− 12.7	+ 38.5	+ 1.5†	− 0.8	− 3.4	+ 13.0
All other net recoveries (+) or charge-offs (−)	− 1.0	− 0.4	− 1.7	− 4.6	+ 0.8	− 1.0	− 1.0	− 1.1
Net additions to (−) or deductions from (+) valuation reserves for:								
Loan losses	—	− 4.7	− 0.3	+ 2.1	—	− 1.4	− 1.5	− 2.6
Security losses	—	− 2.2	+ 1.0	− 10.2	—	+ 0.1	− 0.2	− 4.2
Net profits before income taxes	93.3	130.0	156.0	197.9	35.3	40.7	50.2	65.2
Taxes on net income	30.7	59.6	77.9	88.8	8.9	14.7	20.7	27.4
Net profits after income taxes	62.6	70.4	78.1	109.1	26.4	26.0	29.5	37.8
Cash dividends paid or declared	40.0	43.6	48.4	51.1	8.7	9.9	11.4	13.0
Retained earnings	22.6	26.8	29.7	58.0	17.7	16.1	18.1	24.8

* Includes transfers to or from valuation reserves for loan losses.
† Includes transfers to or from valuation reserves for losses on securities.
Sources: Board of Governors of the Federal Reserve System, 1949-53; 1954 figures compiled by the Federal Reserve Bank of New York.

ment securities that was offset to a small extent by the lower yields obtainable on replacements of maturing obligations or issues sold in the open market. In the Second District member banks outside New York City, Government security holdings increased 6 per cent, but earnings from these securities rose only slightly because of the decline in yields and also because of a shortening in the average maturity of the banks' aggregate Government security portfolios.

The New York City banks, on the other hand, not only increased the size of their total Government security portfolios substantially, but in addition lengthened the average maturities of their portfolios moderately. This portfolio lengthening served to cushion the effect of the decline in Government security yields on the City banks' earnings from Government securities. The central reserve city banks' holdings of Treasury bonds maturing after 5 years increased between the first six months of 1953 and the first half of 1954 from 40 to 44 per cent of their total Government security holdings, while the proportion of shorter-term Treasury bonds and notes fell from 49 to 36 per cent. The City banks' portfolio policies apparently were dictated by a loan "runoff" problem that necessitated a shift in their earning assets from loans to Government securities. For many of the Second District member banks outside New York City loan volume was well maintained, and consequently they followed different portfolio policies. In general they shortened the average maturity of their Government security holdings by reducing Treasury note and bond holdings and by increasing their holdings of Treasury bills and certificates of indebtedness.

Interest income from "other securities", which consists mostly of the obligations of States and municipalities, rose with the growth in average holdings of such securities, and increased 11 per cent in the central reserve New York City banks and 9 per cent in the reserve city and country banks.

Interest and discount received on loans increased slightly in the central reserve New York City banks, despite a 4 per cent reduction in average loan volume. Income from loans apparently was maintained by a slightly higher average rate structure on commercial and industrial loans, which account for two thirds of City bank loan portfolios. In the Second District member banks outside New York City, loan income rose 14 per cent, in close association with the growth in average loan volume.

Receipts from service charges on deposit accounts continued

SELECTED ECONOMIC INDICATORS
United States and Second Federal Reserve District

Item	Unit	1954			1953	Percentage change	
		July	June	May	July	Latest month from previous month	Latest month from year earlier
UNITED STATES							
Production and trade							
Industrial production*	1947-49 = 100	124*p*	124	124	137	#	− 9
Electric power output*	1947-49 = 100	176	173	169	165	+ 2	+ 7
Ton-miles of railway freight*	1947-49 = 100	—	88*p*	93	101	− 5	−14
Manufacturers' sales*	billions of $	24.2*p*	24.2	24.0	26.4	#	− 8
Manufacturers' inventories*	billions of $	44.2*p*	44.5	44.8	46.5	− 1	− 5
Manufacturers' new orders, total*	billions of $	22.6*p*	22.9	22.8	24.5	− 1	− 8
Manufacturers' new orders, durable goods*	billions of $	9.9*p*	10.0	10.1*r*	11.6	− 1	−15
Retail sales*	billions of $	—	14.4*p*	14.0	14.5	+ 3	#
Residential construction contracts*	1947-49 = 100	240*p*	227	216	175	+ 6	+37
Nonresidential construction contracts*	1947-49 = 100	195*p*	193	178	170	+ 1	+15
Prices, wages, and employment							
Basic commodity prices†	1947-49 = 100	91.5	92.3	92.8	87.9	− 1	+ 4
Wholesale prices†	1947-49 = 100	110.4*p*	110.0	110.9	110.9	#	#
Consumer prices†	1947-49 = 100	115.2	115.1	115.0	114.7	#	#
Personal income (annual rate)*§	billions of $	—	286.4*p*	286.2	288.2	#	#
Composite index of wages and salaries*	1939 = 100	—	n.a.	255*p*	250	#	+ 3
Nonagricultural employment*	thousands	48,037*p*	48,119*p*	48,178	49,905	#	− 4
Manufacturing employment*	thousands	15,813*p*	15,997*p*	16,039	17,507	− 1	−10
Average hours worked per week, manufacturing†	hours	39.4*p*	39.6	39.3	40.3	− 1	− 2
Unemployment‡	thousands	3,346	3,347	3,305	1,548	#	—
Banking and finance							
Total investments of all commercial banks	millions of $	79,970*p*	79,090*p*	78,570*p*	77,560	+ 1	+ 3
Total loans of all commercial banks	millions of $	67,210*p*	67,220*p*	67,120*p*	65,630	#	+ 2
Total demand deposits adjusted	millions of $	100,110*p*	98,310*p*	98,700*p*	97,390	+ 2	+ 3
Currency outside the Treasury and Federal Reserve Banks*	millions of $	30,028*p*	30,006	30,013	30,225	#	− 1
Bank debits (338 centers)*	millions of $	63,416	64,335	60,854	64,771	− 1	− 2
Velocity of demand deposits (338 centers)*	1947-49 = 100	119.4*p*	123.1	119.4	121.9	− 3	− 2
Consumer instalment credit outstanding†	millions of $	—	21,110	20,932	21,004*r*	+ 1	+ 2
United States Government finance (other than borrowing)							
Cash income	millions of $	2,956	11,265	4,882	3,615	−74	−18
Cash outgo	millions of $	5,142	6,881	6,228	6,001	−25	−14
National defense expenditures	millions of $	3,635	3,929	3,477	4,511	− 7	−19
SECOND FEDERAL RESERVE DISTRICT							
Electric power output (New York and New Jersey)*	1947-49 = 100	138	139	140	142	#	− 2
Residential construction contracts*	1947-49 = 100	—	219*p*	223	160	− 2	+26
Nonresidential construction contracts*	1947-49 = 100	—	214*p*	225	204	− 5	+ 3
Consumer prices (New York City)†	1947-49 = 100	113.3	112.9	112.9	112.1	#	+ 1
Nonagricultural employment*	thousands	—	7,466.7*p*	7,468.5	7,683.7	#	− 3
Manufacturing employment*	thousands	—	2,621.0*p*	2,618.4	2,859.2	#	− 9
Bank debits (New York City)*	millions of $	63,046	60,153	60,750	53,401	+ 5	+18
Bank debits (Second District excluding New York City)*	millions of $	4,304	4,347	4,016	4,692*r*	− 1	− 8
Velocity of demand deposits (New York City)*	1947-49 = 100	163.0	156.1	164.1	140.8	+ 4	+16

Note: Latest data available as of noon, August 30, 1954.
p Preliminary. *r* Revised. n.a. Not available.
* Adjusted for seasonal variation.
† Seasonal variations believed to be minor; no adjustment made.
§ Revised series.
\# Change of less than 0.5 per cent.
‡ Unemployment figures for July 1953 are on the basis of the old sample and, therefore, not necessarily comparable with the figures shown for 1954 which are on the new sample basis; consequently, a percentage change from a year ago is not shown.
Source: A description of these series and their sources is available from the Domestic Research Division, Federal Reserve Bank of New York, on request.

their steady upward trend throughout the District. The increase was greater in the reserve city and country banks than in the central reserve New York City banks, however. Gross earnings from trust departments also showed moderate gains over the first half of 1953.

Operating Expenses

In the first half of 1954, all categories of operating expenses except interest payments on borrowed money continued to rise from year-earlier levels. In total, operating expenses increased 9 per cent in the central reserve city banks and 13 per cent in the reserve city and country banks, so that gains of only 2 and 6 per cent, respectively, were recorded in net current operating earnings. Salaries and wages, the largest segment of operating expense, rose 5 per cent in the New York City banks and 12 per cent in the rest of the District's member banks, and reflected a combination of larger bank staffs and higher rates of pay. Interest payments on time deposits increased 70 per cent in New York City and 21 per cent elsewhere in the District, as a result both of a larger volume of time deposits and of higher rates of interest paid. The larger volume of New York City time deposits resulted primarily from a sharp increase in the time deposits of foreign banks. In the reserve city and country banks, on the other hand, the additions to time deposit volume occurred in personal and business accounts and in accounts of States and political subdivisions. In the personal and business account categories, the additions seem in large measure to have been associated with the growth in personal savings; in the case of municipal accounts, the additions probably represent funds temporarily earning a return until needed for municipal construction projects.

Interest and discount paid on borrowed funds, which were comparatively high in the first half of 1953, when money market conditions were tight, were considerably less in the first half of 1954 as money market conditions eased and the need for borrowing from the Federal Reserve Bank or other banks declined.

Nonrecurring Items

Net losses on loans remained small in the first half of 1954, especially when related to the large amount of loans outstanding (17.0 billion dollars in the Second District at the end of 1953). Net security profits, however, amounted to 38.5 million dollars for the City banks and 13.0 million for the reserve city and country banks, the largest recorded since the closing years of World War II. Moreover, they compare with a moderate volume of security losses in the first half of 1953.

Profits and losses on sales of Government and municipal securities vary considerably from time to time, and it is noteworthy that the District's member banks used a substantial portion of their current security profits to bolster their reserves for future losses on securities. The New York City banks used 10.2 million dollars for this purpose, while the reserve city and country banks added 4.2 million dollars to their security loss reserves.

Taxes, Dividends, and Retained Earnings

Despite the elimination of excess profits taxes at the turn of the year, Second District member banks made increased provision for income taxes in the first six months of 1954, because they had larger profits subject to tax. In the New York City banks, however, the rise in income tax liability (14 per cent) was minimized by the fact that almost all of the 27 per cent increase in net profits before taxes took the form of long-term capital gains, on which tax rates are but half of the regular corporate rate. In the reserve city and country banks, where increases in net current operating earnings accounted for an important part of the 30 per cent rise in net profits before taxes, the amounts set aside for income tax payments showed almost a parallel rise of 32 per cent.

Dividend payments continued the steady but conservative upward trend of the past decade. As annual rates of return on total capital funds on hand at the beginning of the year, dividend payments in the first half of 1954 amounted to 4.0 per cent in the New York City banks and 3.1 per cent in the reserve city and country banks; in the first half of 1953, the annual rates were 3.9 per cent in New York City and 2.9 per cent in the rest of the District.

In addition to permitting increased dividend payments, the sharp rise in net profits of Second District member banks in the first half of 1954 also made possible substantial additions to capital funds. The central reserve New York City banks retained and added to their capital funds 58 million dollars—53 per cent of their first half net profits. The District's reserve city and country banks retained 25 million dollars, nearly two thirds of their net earnings during the period.

DEPARTMENT STORE TRADE

Preliminary estimates indicate that seasonally adjusted August sales at Second District department stores were approximately the same as in July, but were 2 per cent higher than in August 1953. Sales at New York City department stores are estimated to have risen 1 per cent in August over July, and 3 per cent over August a year ago. For the year to date, department store sales in the District equaled those in the corresponding period last year.

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

Item	1954			1953
	July	June	May	July
Sales (average daily), unadjusted	73	99	98	75
Sales (average daily), seasonally adjusted	101	102	100	104
Stocks, unadjusted	104	107	118	106r
Stocks, seasonally adjusted	117	114	115	120r

r Revised.

Inventories and Outstanding Orders of Second District Department Stores

Inventories held by Second District department stores have declined substantially over the past year from the peak level they reached (on a seasonally adjusted basis) in August 1953. That peak, as Chart 1 indicates, resulted from a decline in department store sales beginning in April 1953 that was coupled in May and June with a high and rising level of outstanding orders placed by the District's department stores.

Outstanding orders fell sharply in the last half of the year, as store managements attempted to "work off" inventories. This conservative inventory policy, together with improved sales, reduced the dollar value of stocks as of the end of February this year by 10 per cent below the August 1953 peak, to the lowest level in about three and a half years.

In magnitude, as may be seen from Chart 2 (based on a larger sample of stores than Chart 1), the recent inventory adjustment was somewhat smaller than the earlier ones of 1948-49 and 1951-52. It was also the shortest, with a peak-to-trough duration of six months, compared with seven months in 1951-52 and twelve in 1948-49. Since the end of February, the dollar value of stocks has been rising again, and this renewed inventory build-up has proceeded more rapidly this year than it did in 1949, 1952, or 1953. At the end of July, however, Second District department store inventories were still 4 per cent below their August 1953 high and 3 per cent lower than in July 1953. Also, the value of outstanding orders, expressed as a percentage of end-of-month inventories, has been below comparable 1953 figures in each month this year except March, despite the fact that inventories themselves have been consistently below year-earlier levels. Moreover, the dollar volume of outstanding orders has been below previous-year levels since last August, and at the end of July was 7 per cent under the corresponding 1953 figure.

In relation to sales, however, the pace of current inventory growth this year has equaled that of 1953, as is evidenced by a year-to-year comparison of ratios of inventories to sales. (The effects of price changes are eliminated in such comparisons, since both inventories and sales are valued at current prices.) For the period beginning with March, when the inventory build-up started, and extending through July, the ratio of inventories to sales (which measures the number of months' supply of goods on hand at the current rate of sales) has averaged 3.2, the same as in 1953. The July ratio of 3.8 also equals July of last year.

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

Area	Net sales			Stocks on hand July 31, 1954
	July 1954	Jan. through July 1954	Feb. through July 1954	
Department stores, Second District	−2	−1	0	−3
New York—Northeastern New Jersey Metropolitan Area	−2	0	0	−3
New York City	−2	0	0	−5
Nassau County	—	—	—	—
Westchester County	+2	+4	+4	+2
Northern New Jersey	−4	−2	−2	−1
Newark	−6	−2	−2	−2
Fairfield County	−1	−6	−6	−8
Bridgeport	−2	−6	−6	—
Lower Hudson River Valley	+4	+1	+1	−3
Poughkeepsie	+2	+1	+1	−3
Upper Hudson River Valley	−3	−3	−2	−15
Albany-Schenectady-Troy Metropolitan Area	−3	−3	−2	−15
Albany	0	−3	−2	−25
Schenectady	−8	−3	−2	−1
Central New York State	−7	−3	−3	−1
Utica-Rome Metropolitan Area	0	−5	−4	−6
Utica	+4	−2	−1	−7
Syracuse Metropolitan Area	−9	−3	−2	+1
Northern New York State	+6	−7	−7	−10
Southern New York State	0	−3	−2	−3
Binghamton Metropolitan Area	0	−2	−2	+1
Elmira	−1	−7	−6	−14
Western New York State	−4	−1	−1	+3
Buffalo Metropolitan Area	−3	−3	−3	+1
Buffalo	−4	−3	−3	+1
Niagara Falls	0	+2	+3	—
Rochester Metropolitan Area	−4	+2	+3	+6
Apparel stores (chiefly New York City)	+2	−1	−1	−3

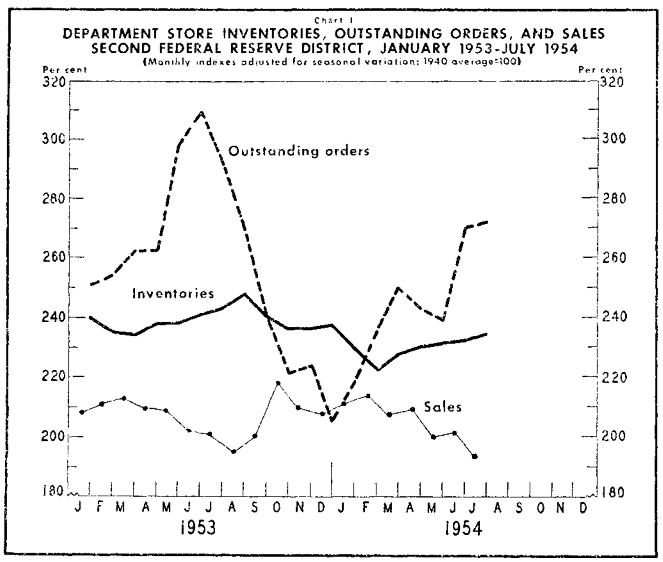


Chart 1
DEPARTMENT STORE INVENTORIES, OUTSTANDING ORDERS, AND SALES SECOND FEDERAL RESERVE DISTRICT, JANUARY 1953-JULY 1954
(Monthly indexes adjusted for seasonal variation; 1940 average=100)

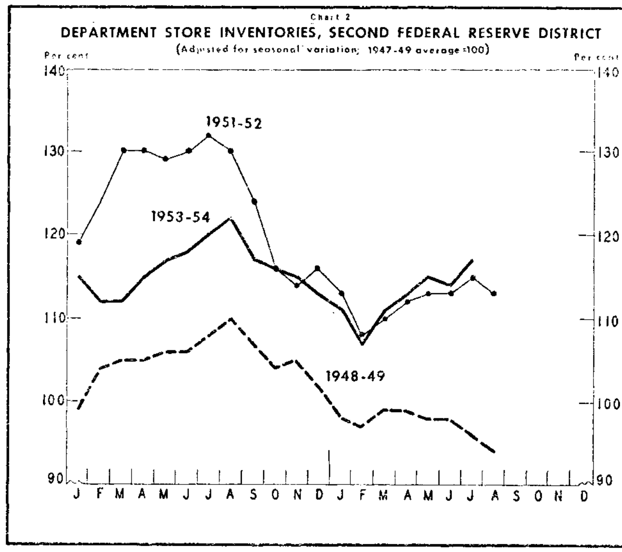


Chart 2
DEPARTMENT STORE INVENTORIES, SECOND FEDERAL RESERVE DISTRICT
(Adjusted for seasonal variation; 1947-49 average=100)