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MONEY MARKET IN APRIL

During the month of April, business activity continued to rise and the demand for credit remained active. Total loans of the weekly reporting member banks were at an all-time high, and, in addition, it was recognized that the Treasury would have to raise funds in May (largely to retire maturing obligations). In this setting, there was an increasing expectation in the money market and securities markets that the Federal Reserve Banks would increase their discount rates, and that the action would be taken well in advance of the Treasury's announcement of the new financing. As a result, the markets moved toward new levels. And, when the Federal Reserve Bank of Kansas City announced on April 13, with the approval of the Board of Governors of the Federal Reserve System, that it would increase its discount rate effective April 14, there were only modest market reactions. In fact, the increase, which was followed the next day by similar action at several other Federal Reserve Banks, seemed to clear away uncertainties and to stabilize market conditions in the latter part of the month.

Short-term money rates moved up rather sharply early in the month and then remained firm or, in some cases, increased further, despite the fact that bank reserve positions generally became easier over the month as a whole. The average issuing rates on Treasury bills increased from 1.374 per cent for the last issue in March to 1.466 per cent and 1.652 per cent, respectively, for the first and second issues in April. On April 12, for the second time in less than two weeks, commercial paper dealers raised rates about ⅛ per cent. Finance companies followed the next day by announcing a similar increase in the rates paid on their paper. On April 14 the discount rate of the Federal Reserve Bank of Kansas City was raised from 1½ per cent to 1¾ per cent, on April 15 the rate was similarly increased at seven other Reserve Banks (including this Bank), and on April 22 at three more. At the end of the month, the twelfth Reserve Bank announced that its rate would be increased on May 2.

On April 19, as a result both of the increase in the discount rate and of an accumulation of inventory in dealer portfolios, dealers in bankers' acceptances raised their bid and offered rates for all maturities ⅛ per cent, thus making the offering rate for unindorsed 30-90 days' paper 1½ per cent. On April 25 and 26, the third increase in four weeks in rates on finance company paper and open market commercial paper was announced, bringing rates on 30-90 days' top-quality finance paper to 1¾ per cent and on prime 4-to-6 months' open market paper to 2 per cent. Rates on loans to Government security dealers by New York City banks were also marked up after the discount rate announcement from a range of 1½-1¾ per cent to 1¾-1⅞ per cent, although loans were frequently available elsewhere at lower rates, and the easing of bank reserve positions made Federal funds available at times at rates well below the Reserve Bank discount rate. Average rates on the last two issues of Treasury bills showed a slight further increase, the average for the issue dated April 21 being 1.664 per cent and that for April 28, 1.697 per cent, the highest level since December 24, 1953. Much of the trading in the market, however, was at somewhat lower rates, generally close to or below 1⅝ per cent for the longer Treasury bills.

In the first week of April, the Federal Reserve Bank of New York, under a new policy adopted by the Federal Open Market Committee, began to buy small amounts of bankers' acceptances from dealers. It also made known to dealers that from time to time, as conditions warranted, it would take acceptances under repurchase arrangements similar to those in effect

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in the Government securities market. The new program was adopted primarily to encourage a broadening of the bankers' acceptance market and increase its usefulness in financing international trade. At the time the System re-entered the acceptance market it abandoned its minimum effective buying rates, and it is making purchases at market rates. During the four statement weeks of April, the Federal Reserve Bank of New York acquired 17 million dollars of acceptances on an outright basis (net of maturing acceptances), and entered into repurchase agreements with dealers in amounts not exceeding 3 million dollars at any one time.

Activity in the Government securities market, other than in Treasury bills, was unusually light in April, as investors awaited first the expected increase in the discount rate and then the announcement of the Treasury's May financing and refunding program. Prices generally drifted down and, for the month as a whole, bond and note prices receded about 1/8 to 5/8 of a point. In the corporate and municipal bond markets, the volume of publicly offered new issues during April was not large. As a result, prices were not subject to any particular pressure, and thus showed little significant change during the month.

After the close of business on April 28, the Treasury announced that it would offer 2 per cent, fifteen-month notes in exchange for the 3.9 billion dollars of 1 1/8 per cent certificates of indebtedness maturing on May 17, and that, in addition, it would offer 2.5 billion of the new notes for cash subscriptions. The books for the new cash offering will be open only one day, May 3, and for the refunding, three days—May 3-5. Payment for the cash portion of the new issue may be made through credits to Tax and Loan Accounts.

Stock prices continued to move up on balance over the month, reaching an all-time high on April 21 and then receding. In addition, bank loans for the purchasing and carrying of securities other than United States Government obligations reached the highest levels since the collection of the current series began in 1944. After the close of the market on April 22, the Board of Governors of the Federal Reserve System announced that effective Monday, April 25, margin requirements on the purchases of listed stocks would be raised 10 percentage points to 70 per cent. The increase apparently was not unexpected, and its announcement caused little immediate reaction in the stock market, although subsequently the market became less buoyant.

The earning assets of the weekly reporting member banks rose sharply in the most recent four weeks for which data are available. Purchases by these banks on April 1 of more than one billion dollars of the new 1 3/8 per cent June tax anticipation certificates account for the largest part of the increase, but loan portfolios also continued to expand. All types of loans increased during the four statement weeks ended April 20 except commercial loans. The decline in this category was considerably smaller than that in the corresponding period of 1954 and reflects, to some extent, redemptions by the banks of part of their holdings of the 1 5/8 per cent Commodity Credit Corporation certificates of interest.

Table I
Weekly Changes in Factors Tending to Increase or Decrease Member Bank Reserves, April 1955
(In millions of dollars; (+) denotes increase, (—) decrease in excess reserves)

Factor	Statement weeks ended				Four weeks ended Apr. 27
	Apr. 6	Apr. 13	Apr. 20	Apr. 27	
Operating transactions					
Treasury operations*	+420	+ 69	−130	−120	+239
Federal Reserve float	+ 93	+ 35	+113	− 47	+194
Currency in circulation	−162	+ 59	+127	+ 57	+ 81
Gold and foreign account	+ 5	− 79	− 27	+ 25	− 76
Other deposits, etc	− 23	+ 35	− 11	+ 11	+ 12
Total	+334	+119	+ 72	− 73	+452
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	—	—	—	—	—
Held under repurchase agreements	+ 40	− 3	− 37	—	—
Bankers' acceptances	+ 13	+ 4	+ 2	—	+ 19
Loans, discounts, and advances	+ 16	− 70	− 68	− 83	−205
Total	+ 69	− 69	−103	− 83	−186
Total reserves	+403	+ 50	− 31	−156	+266
Effect of change in required reserves†	−316	+ 41	+ 6	− 45	−314
Excess reserves†	+ 87	+ 91	− 25	−201	− 48
Daily average level of member bank:					
Borrowings from Reserve Banks	519	567	426	462	494
Excess reserves†	505	688	696	654	636

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

Member Bank Reserve Positions

Bank reserve positions in the aggregate were somewhat more comfortable during April than they were during March for two principal reasons: the Treasury returned to the market the funds that it had taken out in March, and float remained at unusually high levels for an extended period, owing to delays in check collections occasioned by bad weather. The processing of corporate income tax payments in the latter part of March had been more rapid than had been anticipated, and, as a result, the Treasury's deposits with the Reserve Banks had been built up rapidly, drawing a corresponding amount of reserves from the banking system. In the first week of April, partly through payments by the Commodity Credit Corporation for a substantial volume of matured wheat loans, the Treasury's balance was brought down to a more normal working level, adding 420 million dollars to bank reserves in the process. The float expansion occurred in the last two weeks of the month, when rains and fog in the eastern part of the country impeded air transportation and delayed check collections. As it happened, the expansion occurred largely between statement dates so that the importance of this factor is not fully reflected in Table I; it is evident primarily in the sustained high level of average excess reserves during the weeks of April 20 and 27.

For the four statement weeks of April as a whole, the banking system gained 239 million dollars from Treasury operations and 194 million and 81 million, respectively, from an expansion of float and a modest net return flow of currency from circulation. The larger part of these reserve gains, however, was offset by losses through gold and foreign account operations and through a large increase in required reserves. This latter increase occurred during the first week of the month and reflected the expansion of deposits that resulted from bank purchases of more than half of the 3.2 billion dollars of 1⅜ per cent tax anticipation certificates issued by the Treasury on April 1.

The System Open Market Account did not enter the market at all during April. Limited amounts of securities were taken by the Federal Reserve Bank of New York under repurchase contracts during the first statement week, however, to relieve some temporary market tightness, but these were retired subsequently. In addition, the New York Bank, as noted earlier, acquired a small amount of bankers' acceptances both through outright purchases and repurchase agreements.

As a result of their easier reserve positions, member banks in the aggregate were able to reduce their borrowings from the Reserve Banks by 192 million dollars over the four-week period, although they reduced their excess reserves by about 48 million. On a daily average basis, member bank borrowing for the four weeks totaled 494 million, compared with 462 million for the five weeks of March, while excess reserves, according to preliminary data, averaged about 636 million in April against 585 million in March.

The change in bank reserve positions during April was most marked in Chicago. The central reserve city banks there were borrowing heavily at the end of March and early April, owing at least in part to transactions in connection with avoidance by their customers of a personal property tax assessed as of April 1. To reduce their tax liability, large customers of the Chicago banks usually make arrangements with the banks to purchase a substantial amount of Treasury bills from them temporarily over the April 1 date, and also to transfer deposits to other cities. This means that the Chicago banks carry more bills than they would otherwise do in preparation for the tax date and they also lose some of their deposits temporarily. In the weeks ended March 30 and April 6, the average borrowings of these banks amounted to 220 million and 250 million, respectively. By the week of April 20, however, this average had been reduced to 53 million. As the Chicago banks readjusted their reserve positions early in April, the pressure began to shift to New York where member bank borrowings rose from zero in the week of April 6 to an average of 69 million during the week of April 13. This situation, however, was relieved as float expanded and funds moved to New York, and the New York banks were able to reduce their borrowings again in the next two weeks. Borrowings of the reserve city and country banks, on the other hand, continued to rise gradually on balance throughout April, as they have been doing since the beginning of the year.

The Market for Government Securities

Uncertainty initially as to Federal Reserve policy and then as to the Treasury's prospective financing plans was in some measure responsible for holding the volume of activity in the Government securities market to a minimum in April. The retail trading (i.e., buying or selling by investors as contrasted with trading among dealers) that did occur was largely concentrated in the short end of the market. At the beginning of the month, the rising demand for bank credit and the strength of the business recovery, together with the fact that the Federal Reserve System had taken only limited action to relieve the rather tight conditions in the money market at the end of March and in early April, appeared to be interpreted in the market as an indication that the System intended to keep a fairly firm rein on credit expansion and that the discount rate would probably be raised. The logical time for such an increase in view of the Treasury's prospective financing needs was generally assumed to be mid-April. With this situation in mind, dealers marked prices of all Government obligations down, and many investors tended to wait to see where prices and yields would settle. In the short market, prices were further depressed early in the month by sales of Treasury bills, by banks adjusting their reserve positions, and by the reduction in bill holdings in Chicago. Initially, nonbank demands were not large enough to clear these securities out of the market at current rates, since investable funds had been reduced by March 15 income tax payments and absorption of part of the new tax anticipation certificates.

Between March 31 and April 12, yields on outstanding bill issues rose from a range between 1.25 per cent for the shortest and 1.41 per cent for the longest maturity to a range from 1.50 to 1.66 per cent (bid quotations), and, as noted earlier, the average issuing rates on the April 7 and 14 issues of new bills moved up from 1.374 per cent at the end of March to 1.466 per cent and 1.652 per cent, respectively. In the same period, prices of intermediate and long-term bonds declined as much as ½ point, with almost no buying interest appearing outside of continued small purchases of the 3 per cent bonds of 1995.

On April 13, partly in response to the emergence of a modest nonbank demand for short-term issues, principally Treasury bills and the new June tax anticipation certificates, market sentiment changed somewhat and prices of most issues were marked up. The announcement after the close of business that day that the Federal Reserve Bank of Kansas City had increased its discount rate seemed to "clear the air" by removing the uncertainty which had been overhanging the market. While dealers as a precautionary measure marked down the whole list of Government obligations at the opening of the market on the following day, no selling appeared, so prices were marked back up again, and most sectors of the market continued to show some improvement pricewise for the next several days. Retail buying interest, however, remained negligible except for a few swaps in the intermediate area and some small orders for the longest bonds.

In the last week of the month, as the market waited for the announcement of the terms of the Treasury's May offering, bond and note prices again began to drift down. The expectation that the Treasury offer would include a note issue tended to depress prices of issues in the 1957-58 maturity range in particular. In addition, selling of intermediate and long-term bonds by institutional investors increased.

On April 29, after the announcement of the financing program, the 1⅛ per cent certificates maturing May 17 dropped to a bid of about par, although the volume of these securities offered in the market was limited. A demand developed for Treasury bills on the part of some corporations and other investors who, for various internal reasons, did not wish to exchange for a security carrying a term as long as fifteen months. Bill yields, as a result, declined somewhat. The only significant reaction in the longer Treasury issues occurred in the 1957-58 maturity range in which prices were firmer.

For the month as a whole, yields on outstanding Treasury bill issues increased as much as 25 basis-points to a range of 1.50-1.59 per cent by April 29. Bond and note prices were generally down ⅛ to ⅝ of a point, although the three partially tax-exempt issues still outstanding experienced a somewhat sharper decline than the rest of the market (on April 29 the 2¾'s of 1960-65 closed $^{24}/_{32}$ below the end of March) and the long-term 3's did significantly better than the rest of the long-term market, gaining $^{1}/_{32}$ over the month as a whole.

The Market for Other Securities

The corporate and municipal security markets were more active during April than the Government security markets, although the volume of new offerings during the month was only moderate. Prices of outstanding bond issues showed little change. Yields on offering prices of new issues were also largely unchanged, although increased investor resistance to the prevailing rates on new corporate issues developed. Municipal offerings during April, according to preliminary data, amounted to about 365 million dollars, somewhat below the preceding three months and well below the monthly average in the last quarter of 1954. The Blue List of outstanding dealer inventories showed little net change from week to week, averaging about 235 million dollars. The largest offering to come to the market during April was the 112 million dollar issue of Housing Authority bonds. The initial reception accorded these bonds was considerably better than that received by the 118 million dollar offer of similar bonds last January. On the average, the terms for these bonds reflected a somewhat higher reoffering yield than the preceding issue, with the major upward adjustments being made in the earlier maturities which had been slow moving in the previous offering. The April bonds were also made more attractive by virtue of the relatively light municipal calendar. The amount of new turnpike financing this year to date has been about 50 million dollars, and no such issues are definitely scheduled for the immediate future, although several substantial flotations are awaiting settlement of pending litigation. In the last four months of 1954, in contrast, nearly 700 million dollars of such bonds were sold, more than 250 million in December alone.

Table II

Weekly Changes in Principal Assets and Liabilities of the Weekly Reporting Member Banks

(In millions of dollars)

Item	Statement weeks ended				Change from Dec. 29, 1954 to Apr. 20, 1955
	Mar. 30	Apr. 6	Apr. 13	Apr. 20	
Assets					
Loans and investments:					
Loans:					
Commercial, industrial, and agricultural loans	− 40	− 148r	+ 94r	− 13	+ 107
Security loans	+ 5	+ 179	—	+ 66	+ 40
Real estate loans	+ 42	+ 8	+ 35	+ 25	+ 366
All other loans (largely consumer)	+ 53	+ 33	+ 26r	+ 43	+ 350
Total loans adjusted*	+ 66	+ 64r	+154r	+121	+ 807
Investments:					
U.S. Government securities:					
Treasury bills	−410	+ 453	−167	+159	− 812
Other	−214	+1,087	−162	−192	−2,027
Total	−624	+1,540	−329	− 33	−2,839
Other securities	+ 17	+ 29	− 15	− 47	+ 390
Total investments	−607	+1,569	−344	− 80	−2,449
Total loans and investments adjusted*	−541	+1,633r	−190r	+ 41	−1,642
Loans to banks	+ 90	− 187r	− 75r	+101	+ 148
Loans adjusted* and "other" securities	+ 83	+ 93r	+139r	+ 74	+1,197
Liabilities					
Demand deposits adjusted	−692	− 504	+763	+764	−1,832
Time deposits except Government	− 10	+ 35	− 37	− 49	+ 88
U. S. Government deposits	− 81	+1,765	−811	−355	+ 533
Interbank demand deposits:					
Domestic	+108	+ 601	+189	−489	− 823
Foreign	+ 12	− 17	+ 39	− 10	− 28

r Revised.

* Exclusive of loans to banks and after deduction of valuation reserves; figures for the individual loan classifications are shown gross and may not, therefore, add to the total shown.

The volume of corporate bond offerings, estimated at about 300 million dollars in April, was below the March total of more than 500 million, but was somewhat higher than January and February. In the process of distributing two of the larger corporate offerings during the month, some investor resistance was encountered at the reoffering prices, apparently in part because the spread began to appear inadequate in relation to the yield of 2.98 per cent available in the market on the longest issue of Government bonds.

Member Bank Credit

Loans of the weekly reporting member banks in the four weeks ended April 20 (the latest date for which figures are available) increased by 405 million dollars. In the comparable weeks of 1954, they declined by 386 million. The most important single factor responsible for the difference in experience between the two years was the movement of commercial loans. Last year commercial, industrial, and agricultural credits declined by 473 million dollars, while this year the decline amounted to only 107 million. In addition, each of the other major loan classifications shown in Table II increased more or declined less this year than last. Total investments of these banks were up 538 million dollars in the four-week period this year against a net increase last year of only 13 million, this difference, as noted earlier, being largely accounted for by the banks' purchases of the new tax anticipation certificates (TACs) on April 1.

A study of the changes in portfolios during the past twelve months indicates even more striking differences in the position of the reporting banks. In the year ended April 20, 1955, the total loan portfolios of these banks increased by more than 3 billion dollars. Loans for purchasing and carrying securities and real estate loans both increased about a billion dollars, while consumer loans were up approximately 800 million and commercial, industrial, and agricultural credits about 200 million. The most rapid rate of growth has been in loans for purchasing or carrying securities. This category has increased by nearly 39 per cent in the past year to 3.8 billion dollars. Real estate loans increased about 15 per cent over the year, and consumer credit 11 per cent. But since commercial, industrial, and agricultural loans, which still account for more than half of the banks' total loan portfolios, increased less than 1 per cent over the year, the increase in the total loan portfolio was less than 8 per cent.

The Government security portfolios of the reporting banks increased during the twelve months ended April 20 by 2.6 billion dollars, or also by about 8 per cent, and have experienced a marked lengthening of the average maturities in the process. Short-term Treasury bill and certificate holdings (including the June TACs) declined 1.6 billion from the year-ago figure, while holdings of notes and bonds increased by 4.2 billion. On April 20 these banks held 1.7 billion dollars of bills, against 2.4 billion on April 21, 1954 and 1.7 billion on April 22, 1953. Certificate holdings were 2.0 billion, compared with 2.9 billion and 2.1 billion, respectively, while total holdings of Government obligations were 34.1 billion this year, compared with 31.5 billion and 29.4 billion, respectively, for the preceding two years.

EXPANSION AND ADJUSTMENT IN GREAT BRITAIN

The rapid expansion of the British economy during 1954 resulted in the emergence of excessive internal demand toward the end of the year, and contributed to the development of balance-of-payments strains for the first time since 1951. In the three-year interval, the government made large strides in freeing the economy from direct controls, both internal and external. In accord with this policy, Britain is seeking to cope with its present international economic problems through the use of traditional monetary measures. The fact that this represents Britain's first postwar endeavor to correct a balance-of-payments deficit without recourse to intensified trade and payments restrictions gives these measures additional significance.

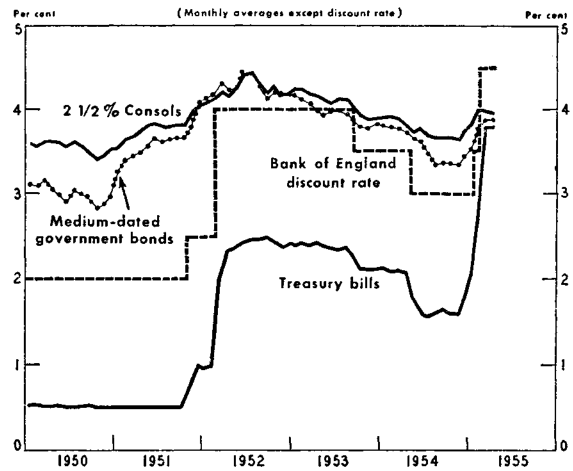
Domestic Expansion

The rapid growth of production that characterized the British economy in 1953 continued in 1954. The rate of growth, which fell just short of a postwar record, was influenced initially by the rise in exports during the winter of 1953-54. Though exports leveled off early in the year, the growth of the economy was sustained by a continuing expansion of consumer demand based mainly on higher rates of pay but also on rising employment. In addition, there was a further rise in investment.

Much of the rapid growth in the domestic economy was attributable to manufacturing, in which output averaged over 8 per cent higher in January-June 1954 than a year earlier. The expansion continued during the rest of the year although at a slower rate, manufacturing output averaging 6½ per cent higher in the second half than a year earlier.

The generally prosperous economic conditions were in part attributable to the government's fiscal and monetary measures. In January 1954, the Excess Profits Levy ended and sales taxes on a wide variety of consumers' goods were reduced. Sanguine expectations may have been stimulated by the presentation in April 1954 of Chancellor Butler's budget for the fiscal year ended March 31, 1955, which provided for increased expenditures, no significant changes in taxation, and a rise in the over-all deficit of 100 million pounds over the year before. The fact that the government's budgetary position would actually improve, rather than deteriorate, only became apparent later in the year. The budget also increased incentives for private investment by liberalizing the depreciation allowances for capital expenditures on new plant and equip-

Chart I
BRITISH INTEREST RATES
(Monthly averages except discount rate)



Latest data are for first three weeks of April; March and April are preliminary.

ment. Subsequently, the expansive influence of fiscal policy was supplemented by an easing of monetary policy. The discount rate of the Bank of England was reduced to 3 per cent in mid-May from 3½, at which it had stood since September 1953, and interest rates fell (see Chart I). In July 1954, monetary policy was eased further when direct controls over instalment buying were revoked.

As the capacity of the economy became more fully utilized during the year, signs of inflationary strains began to appear. The London Clearing Banks' loans to business and individuals, after showing little change between the first halves of 1953 and 1954, exceeded year-earlier levels by almost 11 per cent in the second half of 1954, and in January-March 1955 were 15 per cent higher than in the comparable 1954 quarter. Although the improvement in the government's financial position tended to offset this expansion, the money supply nevertheless averaged 4 per cent higher in the five months ended February 1955 than a year earlier. An increase in the velocity of circulation was indicated by a rise of commercial bank clearings that was proportionately larger than the increase in the money supply.

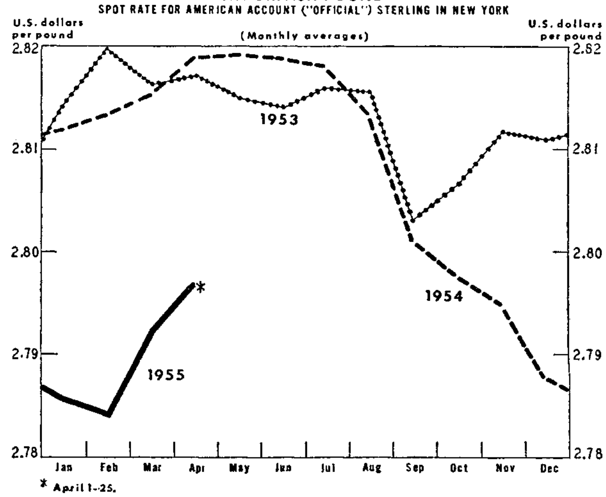
For the year as a whole, money incomes rose more rapidly than aggregate physical output. While output rose 4 per cent above the 1953 level, wages and salaries rose 7½ per cent, gross profits 7½ per cent, and the incomes of self-employed persons 5 per cent. In manufacturing industries, the average earnings per employee seem to have increased by the full amount of the increase in productivity. After the first quarter of 1954, the number of reported job openings rose substantially above the number of unemployed while the upward pressure on wage rates continued.

These developments in the domestic economy were reflected in a deterioration in the balance of payments in the winter of 1954-55. Expanding domestic demand tended to slow down the rise in exports and increase imports, while growing industrial production outstripped domestic supplies of such important raw materials as coal, steel, and tin plate, as a result of which increased supplies had to be imported from abroad. The consequent increase in Britain's trade deficit tended, by increasing the supply of goods available in the British market, to prevent the higher internal demand from manifesting itself in any substantial rise in domestic prices. While it is true that the retail price index was 4 per cent higher in the winter of 1954-55 than a year earlier, most of this rise was apparently attributable to special factors, such as the relaxation or abolition of controls, and to the increase in the prices of imported foods.

The Position of Sterling

Although the rapid growth of the British economy and the increase in demand were the principal factors in the appearance of balance-of-payments strains in late 1954, the weakness of sterling was also influenced by a rise of import prices and by adverse payments developments in the overseas sterling area.

Chart II
THE BRITISH POUND
SPOT RATE FOR AMERICAN ACCOUNT ("OFFICIAL") STERLING IN NEW YORK
(Monthly averages)



The difficulties in the winter of 1954-55 contrasted with the strong position of sterling in 1953 and early 1954.

In the first half of 1954, British gold and dollar reserves increased by 499 million dollars, only slightly less than in the first half of 1953. During the same period the American account ("official") sterling-dollar exchange rate showed marked strength and, during the second quarter, pushed hard against the official ceiling of $2.82 (see Chart II). These developments took place against the background of business recessions in the United States and Canada. While both British and overseas-sterling-area exports to the dollar area declined partly as a consequence of lower North American demand, the drop actually was moderate, and the effects were offset in part by lower British imports from the dollar area and by increased sales of gold in Britain by the overseas sterling area. The sterling area's payments position vis-a-vis nondollar countries remained relatively strong.

Part of the strength of sterling in the first half of 1954 was attributable to the major change in the British exchange control regulations in March, by which the various types of bilateral sterling accounts were amalgamated with existing transferable sterling.[1] At the same time, the London gold market was reopened and a new type of sterling, so-called registered sterling, was introduced: this could be obtained by transferable account countries in exchange for gold or dollars, and could be used to purchase gold in London. The greater usefulness of sterling resulting from these measures tended to create a need for higher working balances of sterling, and foreign capital consequently tended to flow into London. The

[1] Essentially, the new regulations recognized three major types of sterling: resident sterling, held by residents of the sterling area; American account ("official") sterling, held by dollar countries and fully convertible; and transferable account sterling, which included virtually all other currently earned sterling, and which could, under the new regulations, be freely transferred among transferable account countries in settlement of either current or capital transactions. For a more detailed discussion of the new regulations, see "Sterling Area Payments and Policies", this *Review*, June 1954.

prospects for early convertibility of sterling, which seemed bright at the time, also contributed to this tendency. Moreover, relatively high interest rates in London made it profitable at times to shift funds from some foreign centers to Britain. One sign of sterling's strength was the rise in the rate at which transferable sterling was exchanged against dollars in unofficial markets outside Britain: in April and May transferable sterling was at a discount of close to 1 per cent from American account sterling, and during most of January-August the discount did not reach 2 per cent.

In the third quarter of 1954 signs of weakness appeared, though these were believed to be largely seasonal. American account sterling fell below $2.80 by the end of September, and transferable sterling was at a 2 per cent discount. Official reserves of gold and dollars declined 116 million dollars during the third quarter, but this was more than accounted for by special payments to European Payments Union (EPU) creditors and to the International Monetary Fund. There were some signs, however, of increasing sterling area imports from both dollar and nondollar countries in the third quarter.

In the final quarter of the year, indications began to appear that the difficulties were of a more-than-seasonal nature. The official sterling-dollar rate continued to weaken, and the discount on transferable sterling increased to 2.3 per cent at the year end, in contrast to 1.6 a year earlier. Moreover, gold and dollar reserves fell substantially as compared with a small increase in the comparable quarter of 1953. Although the disruption caused by the London dock strike in October and its aftereffects provided a partial explanation for the fourth-quarter weakness, developments in early 1955 suggested that the difficulties were more deep-seated. By February 14, the American account sterling-dollar rate had declined to $2.78¼, the discount on transferable sterling hovered around 2.4 per cent, and for the month as a whole the reserves dropped 82 million dollars; this was the largest decline since February 1952, except for August and December 1954 when special dollar payments took place.

Among the factors responsible for the deterioration of the sterling area's position was the sharp rise in British imports from the dollar area toward the end of 1954 and in early 1955. Several influences seem to have been at work. First, as already noted, the British economy, in achieving record levels of production, began to show signs of a too rapid rise in demand. Higher demand and higher production both tended to increase purchases of foreign goods, and the increase in dollar imports may also have been influenced by the gradual reduction in restrictions on dollar imports. Secondly, there appears to have been a change in the timing of British dollar imports; purchases of dollar cereals, for example, were low during the first half of 1954 but rose later, both as the result of poor harvests in Britain and because of domestic requirements that could be postponed no longer. This suggests that the strong position of sterling in early 1954 may have been based in part upon delays in imports, and that the bulge in dollar imports that developed in the final quarter of 1954 and in early 1955 may have been partly the result of a catching-up on postponed purchases.

The rise in British imports was not, however, confined to the dollar area. Total British imports rose sharply, especially in early 1955, in part as the result of a rise in import prices. The price contrast with the first half of 1954, when import prices were about 4 per cent lower than in the comparable 1953 period, was striking: in December 1954 import prices were 4 per cent higher, and by February 1955 were 7 per cent higher, than a year earlier. The over-all effect was to increase sharply the cost of British imports.

The position of sterling was also adversely affected by developments in the overseas sterling area. During the first half of the year the imports of the overseas sterling countries from the dollar area remained highly stable, and the chief adverse influence arose from lower dollar-area purchases of such sterling area raw materials as tin, wool, and rubber. In the second half of the year and in early 1955, there were signs of a revival in exports to the dollar area, but imports of dollar goods also rose, in part as the result of a notable expansion of demand in some independent sterling countries.

The relations between the sterling area and the nondollar world remained relatively favorable during 1954. The monthly payments surpluses with the EPU were for the most part slightly larger than in 1953, and in early 1955 remained at approximately the 1954 level. This strength is probably in part explained by the use of transferable sterling to purchase dollar products through the newly opened international commodity markets in Britain. For the most part these markets still require that dollar commodities be sold only for dollars, but in certain cases the "dollar-for-dollar" rule is not applied. While such transactions tended to increase "invisible" earnings of the sterling area, these gains were undoubtedly more than offset by outlays of dollars that were only partially recouped through the EPU mechanism. As the result of such transactions, the payments position vis-a-vis nondollar countries tended to strengthen and vis-a-vis the dollar area to weaken. The trade balance with EPU and other nondollar countries tended nonetheless to deteriorate, largely as the result of high sterling area merchandise imports.

Another adverse influence upon sterling was the reappearance toward the end of the year of so-called "shunting" transactions, in which transferable sterling is used by traders in third countries to purchase sterling area commodities for sale in the dollar area. The deterioration of the sterling area trade position vis-a-vis nondollar countries toward the end of the year, as well as less optimistic expectations concerning the strength of sterling, tended to drive transferable sterling to the substantial discount already noted. As a result, shunting became profitable and had the effect of strengthening the sterling area's position vis-a-vis the EPU and weakening its position vis-a-vis the dollar area. The net effect, however, on Britain's gold and dollar position tended to be adverse, since Britain received only 50 per cent in gold and dollars on account of increased surpluses with EPU.

The diverse factors that led to the weakness of sterling and the decline in sterling area reserves toward the end of 1954 and in early 1955 can be summarized briefly. First, some of the adverse influences either were outside the reach of normal corrective measures or could be dealt with only by measures running counter to the government's broader economic strategy. Thus, the rise of import prices could not be controlled, while the effects of Britain's liberalization of trade and payments could only be reversed by a retreat from the official policy of furthering such liberalization measures. Secondly, there were those developments that could be controlled without deviating from the goal of freer trade and payments: specifically, the authorities could act to moderate excessive internal demand within Britain, and they could intervene in such a way as to discourage shunting operations. These in fact were the chief goals of the corrective measures that were introduced in the winter of 1954-55.

Corrective Measures

To cope with the balance-of-payments strains, the British authorities tightened their monetary policy and took related measures in the foreign exchange markets. The most important monetary measures were the increases in the Bank of England's discount rate from 3 per cent to 3½ per cent at the end of January 1955 and to 4½ per cent on February 24, and the reintroduction of controls on so-called hire-purchase (instalment credit) sales. In February also, the British Exchange Equalization Account was authorized to operate with wider discretion in unofficial foreign exchange markets where sterling is traded at a discount; this was widely interpreted to mean that action would be undertaken to reduce the discount on transferable sterling.

The tightening of monetary policy is aimed principally at moderating internal demand by restraining the growth of consumer expenditure, encouraging personal saving, and preventing undue inventory accumulation. In this way, the government hopes to facilitate an expansion of exports that will match the increase in imports.

While it is still too early to judge to what extent these aims will be achieved, an auspicious start has been made. In particular, there has been a notable tightening in monetary conditions. Net deposits of the London Clearing Banks contracted sharply between mid-November 1954—when the first signs appeared that monetary policy was becoming firmer—and mid-March 1955, and there was a sharp decline in the banks' liquidity. The main factor behind the change in the banks' position was the government's cash surplus, derived primarily from seasonally large tax receipts but also from sales of foreign exchange in support of sterling. Bank of England operations not only contributed to this contraction but probably were also instrumental in driving money market rates closer to the discount rate than at any time since the war; in addition, these operations may have encouraged greater caution in commercial bank lending policy.

Although the impact of the government's monetary measures has been greatest in the money market, effects have also appeared in other financial markets. Stock market prices, which had been rising almost uninterruptedly for thirty-one months, declined markedly after the discount rate increases and then leveled off. Government bond yields increased for all maturities, while rates charged by the important Public Works Loan Board, through which the central government funnels funds to local government authorities for municipal housing and other capital projects, were brought into line. In part as the result of the higher interest rates in the bond market, new capital issues floated in the United Kingdom in February-March were less than 40 per cent as large as a year earlier. On the other hand, the increase in bank advances from February to March, though relatively small, was slightly larger than a year earlier.

The instalment buying boom began to slow down in March as the result of reimposed controls which call for a minimum downpayment of 15 per cent, with full payment in twenty-four months for most specified commodities. Although the total number of hire-purchase contracts concluded in March 1955 was still 43 per cent above a year earlier, this was a considerable drop from February when the increase had been 71 per cent.

Although the increases in the discount rate aimed at strengthening the balance of payments chiefly by restraining domestic demand, the resulting rise in interest rates also tended to increase incentives for the shift of foreign funds to London. After the January rise in the discount rate, such incentives soon declined as forward sterling moved to a discount; the size of this movement was such that the gains to be obtained from the rise in money market rates in London were offset by the cost of covering by sales of sterling forward. The second and larger rise in the discount rate had, however, a much greater impact on London money market rates and, although the discount on forward sterling increased, this did not apparently prevent a movement of foreign capital to London. In part, this movement may have resulted from the belief following the second discount rate change that the British authorities had acted decisively to strengthen sterling and that an improvement was in sight. After the first discount rate increase, the American account sterling rate continued to decline, while after the second there was a sharp recovery: from a low of \$2.78¼ in mid-February, the rate climbed to \$2.79 on March 3 and stood at \$2.79$^{31}/_{32}$ on May 2. At the same time reserves, which had fallen sharply in February, fell much more moderately in March and rose in April. Higher interest rates, in addition to many other factors, may have influenced this improvement.

The authority to operate with wider discretion in unofficial sterling markets was presumably also designed, in conjunction with higher interest rates, to bolster Britain's position by reducing the discount on transferable sterling and thereby discouraging shunting transactions. Quite apart from actual intervention, market expectations based on the authorization itself tended to reduce the discount, which in fact fell from over 2 per cent on February 23 to 1.3 per cent the following day, and thereafter declined to about 1 per cent on May 2.

In his budget address of April 19, Chancellor Butler indicated that the corrective measures were having the desired results and expressed optimism as to the future, but stressed the importance of continued growth of production and a more intensive export effort. The budget for the year ending March 31, 1956 reflects this optimism, while seeking to provide greater incentives for effort through substantial reductions in income taxes. These reductions cut the basic income tax rate from 45 to 42½ per cent, increased personal and child allowances, and are expected to remove about 2.4 million persons from the income tax rolls; in addition, the purchase tax on certain textiles—an industry in which there is unused capacity—was reduced from 50 to 25 per cent. The ordinary budget, which excludes certain capital expenditures, envisages a surplus of 148 million pounds in 1955-56, compared with the 433 million surplus recorded in the fiscal year just concluded. Including capital expenditures, the estimates show a deficit of 436 million pounds, 368 million larger than the actual deficit in 1954-55 but only 39 million above the original estimates for that year.

Conclusions

The decision of the British authorities to place primary reliance on measures of monetary restraint is in sharp contrast to the use of direct controls over British trade and payments during earlier postwar crises. The authorities have not, of course, been faced with difficulties on the scale of those in 1947, 1949, and 1951, a fact that in itself indicates the greatly strengthened position of Britain as compared with earlier postwar years. But the change also reflects a determination to continue the policies of freer markets and freer trade and payments pursued since 1951. The results of the remedial measures are of great interest not only because of the importance of Britain and the sterling area to the free world, but also because the measures adopted represent the first postwar attempt by the managers of a major international currency to meet balance-of-payments difficulties without recourse to intensified direct controls.

Certain factors entirely independent of the policies adopted in Britain may make the task easier. Thus there is some ground, as already indicated, for attributing a part of the recent weakness of sterling to temporary factors such as the apparent shift in the timing of dollar imports. Similarly, the economic recessions in the United States and Canada exerted a moderately adverse effect on sterling area dollar earnings during 1954 that will tend to disappear if the economic upswing in these two countries continues. These influences might therefore be expected to reinforce the effects of the corrective measures in strengthening the position of sterling.

The impact of excessive internal demand on the balance of payments is, of course, a fundamental problem for Britain. To deal with these strains, primary reliance is being placed upon monetary measures that are aimed at checking an undue growth of inventories and personal consumption and at stimulating savings so as to permit a higher level of investment in plant and equipment. At the same time, reduced taxation is expected to provide incentives for greater effort and continued growth of production. By such policies, the British authorities are seeking to reconcile their domestic objectives of economic growth and full employment with their primary international goal of maintaining a sound balance-of-payments position.

THE PROGRESS OF ECONOMIC RECOVERY

Production of goods and services in the United States has advanced vigorously during the past six months and, by mid-April, it appeared that virtually all the ground lost in the 1953-54 recession had been regained. Gross national product (GNP) during the first quarter of 1955 was estimated at about the 370 billion peak reached two years ago, and current information suggests that a further advance is in progress. Activity in many industries has already passed earlier peaks, and reports are received almost weekly of new production records. The economic scene is not without its problem areas, however. Per capita income of the farm population, for example, remains below the levels reached three years ago, despite the smaller number and higher productivity of farm workers. In industry, earlier production peaks have been reached without full absorption of unemployed job-seekers, and unemployment has tended to stay above earlier prosperity levels. And finally, the likelihood of cutbacks in automobile and steel output and a possible slackening of construction activity later in the year further cloud the economic horizon. But these uncertainties, while significant, may perhaps diminish in importance with the passage of time and a further broadening-out of recovery.

The upturn in business may be dated from last September, when industrial production and nonfarm employment began a sustained advance. To be sure, the advance has not been so vigorous as in some other recovery periods (for example, in the first half of 1950), and there are the areas of weakness or uncertainty mentioned above, but in general the trend seems to be solidly founded, and its moderate rate may be an added source of strength. In addition to rising output and employment trends, the improved business climate has been confirmed by such indications as the Federal Reserve survey of consumer finances early this year, which showed that consumers regard their current and prospective financial situations more favorably now than they did a year ago, and the recent surveys of investment plans that point to higher outlays this year.

Recovery has been paced by record production and sales of new automobiles and record outlays for new construction, but nearly all major sectors of the economy have shared in the advance. Thus, consumer outlays for "soft" goods have risen significantly since last summer and business investment spending has increased recently, with the latest data pointing to a rise in plant and equipment outlays as well as inventory replenishment. In addition to the substantial revival in the private economy, outlays by State and local governments have continued to rise, providing a stimulus to the construction and other industries. Federal spending is at a rate somewhat below that of last summer, but the long decline in national security outlays appears to have come to an end.

The degree of recovery has varied from one industry to another, and, related to this, there have been marked differences in the nature and extent of revival in different parts of the country. Recovery has been especially sharp in the Great Lakes industrial area, for example, where output of transportation equipment, primary metals, and supporting products is heavily concentrated; revival has been more moderate in the Northeast, where the manufacture of "soft" goods is relatively more important and where the impact of the preceding recession had also been more temperate. In addition, the geographical distribution of recovery has reflected the longer-term trends in population and income growth; this, too, has contributed to the more modest appearance of gains in the northeastern States, compared with the southwestern and far western portions of the country where secular and cyclical developments have reinforced one another in recent months.

Factors in the Recovery

In its earlier stage, perhaps continuing through the end of 1954, the recovery seemed to be based on an upward movement in the broad categories of spending, such as consumer outlays, that had been rising or had at least remained strong during the preceding periods of recession and stability. At the same time, there was a flattening-out of Federal spending, which had been declining, although business plant and equipment outlays continued to decline. Consumer spending, after advancing gradually throughout most of 1954, spurted in the last quarter and attained a very high level in December, when a record pre-Christmas sales season coincided with the introduction of new-model automobiles. Similarly, the slowly rising trend of residential construction outlays during the first three quarters of the year was augmented by an acceleration in the demand for new housing units in the final months of 1954 (using seasonally adjusted figures). State and local government spending also advanced in the fourth quarter, continuing the trend that has marked the entire postwar period. Net receipts from foreign countries also rose sharply in the last quarter of 1954 after about a year of gradual increase. Additional impetus to recovery was provided by spending for inventories, which substantially reduced the rate of net stock liquidation in the fourth quarter. Thus, in its initial phase the recovery included no sharp "turn-around" in any of the trends being followed by major components of GNP, although within the broad categories there were such important developments as the dramatic rise in automobile sales from depressed levels earlier in 1954 and the marked upsurge in the construction of homes with Government insured or guaranteed mortgages.

More recently there seems to have been a shift in the relative strength of forces contributing to recovery, with more of the upward thrust originating in business investment outlays and comparatively less in consumer spending and residential building. While consumer purchases in the first quarter of 1955 were well above the preceding quarter, retail buying in the January-March period actually has only held near the record December rate, after seasonal adjustment. Apart from sales in the automotive and household durables groups, retail sales drifted downward during the first quarter. Currently high sales to consumers are supported by record levels of personal income and disposable income, but part of the sales rise since last summer has been financed through an increase in consumer credit, especially in the latter part of 1954.

Residential building outlays in the first quarter of this year, after seasonal adjustment, also exceeded the preceding quarter, but the trend during the most recent months has been sideways. In this area, too, a tendency toward greater reliance upon credit financing became discernible in the latter part of 1954 as downpayment terms eased, notably for mortgage loans insured or guaranteed by Federal agencies. More recently, some leading lenders have cautioned against the creation of too easy credit conditions for such loans, and the Veterans Administration has issued regulations prohibiting the inclusion of closing costs in mortgages that it guarantees.

Meanwhile, greater upward force in the recovery seems to be coming from the investment side. A survey of businessmen's past, current, and prospective plant and equipment expenditures conducted by the Department of Commerce and the Securities and Exchange Commission early this year indicated that the decline in such spending came to an end in the first quarter of 1955, and that a 6 per cent increase was expected in the seasonally adjusted rate during the April-June quarter. A more recent survey by the McGraw-Hill Publishing Company, Inc., indicated that many firms now plan to spend more this year than had been anticipated a few months earlier. New orders for machine tools and for nonelectrical machinery, at sharply higher levels in early 1955 than during most of 1954, may already have reflected expanded capital investment programs. In addition, outlays for private nonresidential construction, after seasonal adjustment, have risen significantly during recent months after more than a year of virtually no change.

Business inventories apparently "touched bottom" last December at a level (seasonally adjusted) some 5 per cent below the September 1953 peak, and in February the first significant rise in seventeen months appeared; the increase centered in distributors' stocks with much of it attributable to higher automobile inventories. The ratio of stocks to total business sales at the end of 1954 was at its lowest point in several years.

Involuntary inventory changes frequently occur at cyclical turning points, and it is probable that many producers and traders were attempting to acquire larger inventories in the closing months of 1954, or at least to resist further inventory depletion, but the high pace of sales forestalled completion of these plans. For manufacturers, there has been a marked rise since last summer in the volume of goods in process, although on a seasonally adjusted basis there was little change in their total inventories during the latter months of 1954 and early 1955. This pattern, along with the recovery of manufacturers' sales to levels not attained since 1953, suggests that some increase in inventories might be comfortably absorbed; indeed, although the latest comprehensive data cover only the first two months of this year, there have been recent scattered indications of more extensive inventory rebuilding. Some of the large current output of steel, for example, reportedly has been going to replenish inventories. Distributors' inventories also have been rising, with increases reported for nondurable goods as well as for such items as automobiles.

As a result of these increases in business investment spending, together with continued high consumer and residential construction outlays and a further gain in State and local government spending, total national product in early 1955 regained the peak level from which it had slipped after the second quarter of 1953. However, while total production was roughly at the same annual rate in these two periods, there were significant changes in its composition. Most important have been the shifts away from national security spending and toward consumer expenditures, amounting respectively to about 14 billion and 11 billion dollars at annual rates. In addition, in the recent period there has been a lower rate of business investment than in the peak period of 1953, but higher spending for housing and for State and local government purposes.

Industrial Production Patterns

These shifts in demand since mid-1953 have shaped the development of industrial production and its components. While the index of total industrial production in March had nearly reached the peak levels attained in 1953 and output of many nondurable manufactures and of minerals had reached earlier records, the production of durable goods, which is most closely associated with "military hardware", was still substantially below peak 1953 rates. On the other hand, the output of durable goods had fallen most sharply in the 1953-54 business recession and has recovered vigorously in the upturn since last summer.

The rise of durable goods output has been strongly influenced by expanding automobile and steel production. Increased output of transportation equipment (principally automobiles) alone accounted for more than 20 per cent of the rise in the index of total industrial production from September to March, and nearly 20 per cent was attributable to higher output of primary metal products (largely steel). Early in the recovery, a preponderant share of the increase in output of transportation equipment could be traced to higher passenger car output, and a large part of the rise in steel production reflected orders from the automotive industry. More recently, a significant part of the gains in transportation equipment has reflected expanded truck production, and the continued rise in steel output has stemmed more and more from the expansion of orders placed by other than automotive industries. Output of machinery and other durable products, apart from transportation equipment and primary metals, changed relatively little during the several months following last September, but production of nonelectrical machinery has risen significantly since the start of this year, and most recently there have been vigorous gains reported for such items as clay, glass, and lumber products. All of these developments have highlighted a broadening of the base of recovery. To some extent, they have also suggested the shift in emphasis noted above among different forces in the recovery, with increased support coming from business investment expenditures (for example, in trucks, machinery, and industrial building) and, in relative terms, a somewhat weaker upward pressure from consumption outlays.

During the first six months of recovery, output of minerals advanced even more sharply than that of durable manufactures. Not only did crude oil and natural gas output advance to record levels, but coal and metal mining also increased substantially. In coal mining, output in early 1955 seemed to mark a notable, though perhaps only temporary, recovery in what has been a secularly declining industry.

While the gains in output of nondurable manufactures have been more moderate than for minerals or "hard" goods, they have been equally impressive for the steadiness of their advance. Since the preceding decline in this type of production was more gentle than for industrial production as a whole, the modest advance in "soft" goods manufacturing has been sufficient to raise its index by March nearly to the peak attained in 1953. Increases have occurred not only in output of chemicals and petroleum and rubber products, which have undergone substantial growth in the postwar period, but also in leather goods and in textiles and apparel. Production of the latter, however, is still considerably below mid-1953 levels and even farther below the all-time peak output. The relatively moderate advance in textile and apparel output, and the low level compared with certain earlier years, finds some reflection in the fact that recovery has been less vigorous in the New York-New England area than in the country as a whole, and notably less than in certain areas where heavy goods manufacturing is concentrated.

Employment Trends

Recovery in employment has followed a pattern similar to developments in production. There seems to be a lag, however, in the rate of employment gains, compared with other measures of activity. The index of industrial production, for example, had nearly regained its peak 1953 level in March, and the average working week in manufacturing had returned to about the same length as in that earlier period, while nonagricultural employment was still far short of such an achievement.

The steady rise in nonfarm employment since last August (according to seasonally adjusted Bureau of Labor Statistics data) has been fed chiefly by gains in durable goods manufacturing, especially transportation equipment and primary metals. The employment gain in "soft" goods manufacturing has been quite moderate, but the number of State and local employees has advanced substantially, continuing the marked upward trend in this sector. Trade employment has advanced moderately, while other major categories of nonagricultural employment have changed relatively little since last summer. In agriculture, where employment seems to be affected only to a limited extent by cyclical swings in the economy, the long-term decline in the labor force appears to have continued.

The unemployment situation also has shown distinct improvement since last summer; the Census Bureau's newly published index of seasonally adjusted unemployment declined about one fifth between August and March. The Census estimates also indicated that unemployment in March was half a million persons less than a year earlier. But the latest unemployment total was 1.5 million greater than two years earlier; moreover, the comparison with one year ago may still be affected by the fact that a new labor force sampling procedure was introduced early last year, although the indicated drop in jobless persons is in line with that suggested by the independently reported series on recipients of unemployment benefits.

The pattern of business revival area by area is also mirrored in the data on employment and unemployment. Recovery has been most apparent in communities where the production of durable goods is important and where labor surpluses had been in greatest evidence. The increased output of automobiles, steel, and fabricated metals, for example, has reduced unemployment in such labor markets as Detroit, Michigan, and Canton, Ohio, while revived demand for farm machinery has brought an expansion of employment in such other cities as Racine, Wisconsin, and Davenport, Iowa.

In the Second District, the recovery in employment has been somewhat less marked than in the country at large, just as the decline here was also more moderate. The low point in total nonagricultural employment, seasonally adjusted, was reached about a month later than in the nation as a whole, and the advance since then has been slight. Although activity in apparel making, which is heavily concentrated in this District, has picked up somewhat in recent months, employment in such durable goods industries as machinery, electrical equipment, fabricated metals, and transportation equipment was between 8 and 10 per cent below the year-earlier levels as recently as February. Buffalo and the Albany-Schenectady-Troy area—both of which are centers of military "hard" goods production—still have "substantial" labor surpluses, according to the United States Department of Labor. Paterson, New Jersey, and the Utica-Rome area are also in this classification, with continued unemployment in both durable and nondurable goods industries, as are a number of smaller communities in central New York State.

Conclusions

The vigorous pace of business recovery in recent months has led some observers to feel that the revival has been too rapid in certain respects. In particular, it has been said that the advanced rates of automobile sales and production, and of home-building, are "borrowing" from future activity in these lines and might be followed by a decline that might possibly endanger the general business recovery. The discussion in preceding sections has suggested that these areas—automobiles and residential construction—may not be able to maintain their present rate of activity throughout the year, but that the recovery is currently deriving a large share of its propulsion from an expansion in other categories of spending, notably business investment. Of course, if much of the upward thrust is drawn from a renewal of extensive inventory accumulation, this development, too, could be a source of potential weakness once the expanded inventory goals are reached.

On the historical record, the rate of business recovery in general has not been unusually rapid. No widespread indication has appeared of more than temporary strains or bottlenecks, and the high degree of price stability at both wholesale and retail levels gives further evidence of the orderliness of the advance. To be sure, the remarkable price stability has included relatively small but significant offsetting movements in farm and industrial prices. While the latter have tended to rise slightly since last summer, prices of farm products and processed foods have drifted downward. This divergence has pointed up the relative weakness of agriculture in a generally improving economy, but the price advances for industrial materials were not sharp enough (except for a few items such as copper) to suggest tight supply conditions.

However sound the current progress of recovery, the gains must be sufficient in the long run to meet the needs of an increasingly productive and more numerous population and working force. In the next several months the economic advance is likely to be tested, as some major industries face the possibility of a slackening in demand. But there are also areas of potentially stronger demand, including business spending for fixed investment and individuals' outlays for a wide range of consumer goods, that may tend to offset any such slackening and may eventually add to the recent substantial gains.

OWNERSHIP OF DEMAND DEPOSITS IN THE SECOND FEDERAL RESERVE DISTRICT

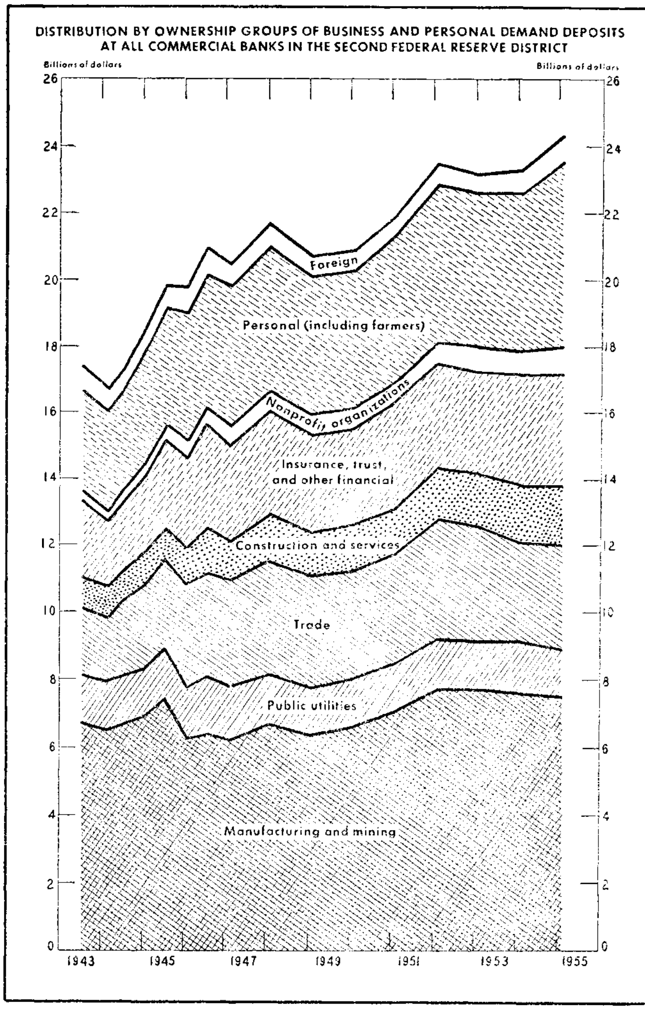
Demand deposits of individuals, partnerships, and corporations[1] in commercial banks in the Second Federal Reserve District reached an estimated all-time high of 24.3 billion dollars on January 31, 1955. This total was over 900 million dollars (4.0 per cent) above the year-earlier figure and nearly 750 million dollars (3.1 per cent) more than the previous peak reached in 1952. As Table I and the accompanying chart indicate, the largest increases during the past year came in personal (including farm) accounts, which rose about 800 million dollars.

These and the other data discussed in this article are drawn from the 1955 survey of demand deposit ownership in the Second Federal Reserve District recently completed by this Bank. This annual survey, which has been conducted since 1943, is part of a nation-wide project undertaken each year by the Federal Reserve System to obtain information on changes in deposit balances held by major segments of the economy.

Most of the past year's increase in demand deposits developed after July 1954, when credit expansion, largely through bank participation in Treasury financing and loans to private borrowers based on an ample supply of reserves, was accompanied by a considerable growth in deposits. From July to October 1954, these additions to the banks' earning assets consisted principally of United States Government securities and municipal obligations. But thereafter, as an upturn in industrial production and seasonal activities increased the credit need of individuals and businesses, a rise in commercial bank loans became the principal element in the further growth of demand deposits.

Changes in Deposit Ownership

As indicated above, the greatest increase in demand deposits was in personal accounts of individuals (including farmers), the growth in which came to 86 per cent of the total year-to-year increase in demand deposits. Gains in personal account balances occurred in all sizes of banks. They were greatest, however, in the largest banks, those with demand deposits of over 500 million dollars, all of which are



[1] All subsequent references to demand deposits refer to demand deposits of individuals, partnerships, and corporations.

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

Type of owner	All commercial banks (792 banks)		
	Jan. 31, 1955	Jan. 1954 to Jan. 1955	
	Dollar balance	Dollar change	Per cent change
Manufacturing and mining	7,526	−121	− 1.6
Public utilities, transportation, and communications	1,436	− 35	− 2.4
Trade	3,120	+134	+ 4.5
Construction	447	− 37	− 7.6
Service industries and professions (excluding public utilities)	1,309	+ 96	+ 7.9
Total nonfinancial business accounts	13,838	+ 37	+ 0.3
Insurance companies and other financial businesses	3,071	+ 70	+ 2.3
Trust funds	377	− 14	− 3.6
Total financial accounts	3,448	+ 56	+ 1.7
Personal accounts	5,484	+796	+17.0
Regular—farmers	*146*	*+ 14*	*+10.6*
Regular—others	*4,919*	*+735*	*+17.6*
Special checking	*419*	*+ 47*	*+12.6*
Nonprofit organizations	753	+ 39	+ 5.6
Foreign	743	—	—
Total demand deposits of individuals, partnerships, and corporations	24,266	+928	+ 4.0

located in New York City. Personal accounts in these banks rose nearly 600 million dollars, or 27 per cent, between January 1954 and January 1955.

The accompanying chart makes it clear that personal account balances have become progressively more important in the deposit structure of the District's commercial banks in the past twelve years. They currently comprise 23 per cent of all demand deposits in this District, as compared with 17 per cent in July 1943 when the first deposit ownership survey was made. This growth of personal accounts probably reflects not only an increase in population and personal income in the District, but also a rise in the proportion of the population that uses checking accounts.

As compared with personal accounts, balances in most other ownership groups of accounts remained comparatively stable from January 1954 to January 1955. Trade account balances increased moderately, probably reflecting the transition from inventory accumulation in 1953 to inventory liquidation in 1954, and possibly also the formation of new firms. (In 1953, trade balances decreased considerably.) The past year's increases in trade accounts occurred in all sizes of banks, but were proportionately larger in the smaller-sized banks in which these accounts are relatively most numerous.

Balances held by service industries (such as theatres, hotels, laundries, garages, etc.) and the professions showed a sizable rise of 7.9 per cent. Balances in these accounts have almost doubled since 1943, when the first deposit ownership survey was made; in fact, their rate of growth has been exceeded only by accounts of nonprofit organizations (such as churches, clubs, labor unions, and relief societies). Accounts of nonprofit organizations rose 5.6 per cent in 1954; they are now at a record high of about 750 million dollars, two and one-half times their 1943 total.

Balances in the accounts of financial enterprises, including the accounts of investment trusts, security dealers, real estate businesses, and insurance companies, increased by 2.3 per cent during the year ended January 31, 1955. About two fifths of these deposits are insurance company deposits.

Demand balances of manufacturing and mining, public utility, and construction concerns all decreased moderately between January 1954 and January 1955. These balances, which now represent 39 per cent of all commercial bank demand deposits in the Second Federal Reserve District, have remained relatively stable in the past four years. Total balances of these depositor groups are influenced, of course, by cash needs for current operations, but after these needs are met, available funds are usually invested temporarily in short-term securities until they are needed for other purposes.

Change in Number and Size of Accounts

Beginning in 1954, the Bank's annual survey of deposit ownership was expanded to permit estimates not only of the dollar volume of deposit accounts owned by various economic groups, but also of the number and average size of these accounts. These estimates are shown in Table II. They indicate that there were approximately 6.2 million checking accounts in the Second Federal Reserve District at the end of January 1955.

Of this total, 4.9 million, or nearly four fifths, were personal checking accounts. These were divided into 2.6 million "regular" checking accounts (in which a minimum balance is usually required) and 2.3 million "special" checking accounts (also known as "checkmaster", "pay-by-check", or "write-a-check" accounts, and requiring no minimum balance). The combined total of 4.9 million personal checking accounts was distributed among an estimated 6.2 million family units and single individuals residing in the Second Federal Reserve District.

Personal checking accounts increased more in number between January 1954 and January 1955 than any other kind.

Table II
Estimated Number and Average Size of Business and Personal Demand Deposit Accounts Held by All Commercial Banks in the Second Federal Reserve District

Type of owner	Number of accounts			Average size of accounts		
	January 31, 1955	Change from January 31, 1954		January 31, 1955	Change from January 31, 1954	
		Actual	Per cent		Actual	Per cent
Manufacturing and mining	137,692	− 14,099	− 9.3	$54,662	+$4,281	+ 8.5
Public utilities, transportation, and communications	34,605	+ 2,707	+ 8.5	41,485	− 4,637	−10.1
Trade	374,707	+ 15,332	+ 4.3	8,327	+ 19	+ 0.2
Construction	46,181	− 1,480	− 3.1	9,680	− 466	− 4.6
Financial	141,673	+ 7,007	+ 5.2	21,674	− 609	− 2.7
Service industries and professions (excluding public utilities)	191,572	− 1,189	− 0.6	6,833	+ 542	+ 8.6
Total business accounts	926,430	+ 8,278	+ 0.9	18,252	− 47	− 0.3
Personal accounts	4,898,997	+245,106	+ 5.3	1,119	+ 112	+11.1
Regular—farmers	*128,116*	*+ 15,188*	*+13.4*	*1,136*	*− 29*	*− 2.5*
Regular—others	*2,509,909*	*+180,116*	*+ 7.7*	*1,960*	*+ 164*	*+ 9.1*
Special checking accounts	*2,260,972*	*+ 49,802*	*+ 2.3*	*185*	*+ 17*	*+10.1*
Nonprofit organizations	249,362	+ 20,730	+ 9.1	3,020	− 106	− 3.4
Foreign accounts	41,538	− 3,179	− 7.1	17,898	+ 1,274	+ 7.7
Total accounts (excluding trust accounts)	6,116,327	+270,935	+ 4.6	3,906	−$ 20	− 0.5
Trust accounts	123,719	*	*	3,049	*	*
All accounts of individuals, partnerships, and corporations	6,240,046	*	*	$ 3,889	*	*

* Data for trust accounts were not reported on January 31, 1954 on a basis comparable with that reported on January 31, 1955. Therefore, year-to-year changes could not be calculated accurately for this item and the over-all totals.

And, within the personal account category, the number of regular checking accounts increased substantially more, both absolutely and relatively, than the number of special checking accounts. Both types of accounts increased in average size, but special accounts increased moderately more (10.1 per cent) than did total regular accounts (8.7 per cent).

Farm accounts (a subdivision of regular personal accounts) increased in number by an estimated 15,000, or 13.4 per cent, in the year ended January 31, 1955; they now total more than 125,000. Accompanying this increase in the number of farm accounts, there was a growth in total farm account balances of 10.6 per cent, to an estimated 146 million dollars. The average size of farm accounts decreased by 2.5 per cent, however, as a result of the large number of new accounts and possibly also as a consequence of the past year's decline in farm income.

The number and average size of all business accounts remained relatively stable from January 1954 to January 1955. The number of manufacturing and mining accounts, however, decreased 9.3 per cent, presumably reflecting at least in part a reduction in the number of firms engaged in such business. However, the substantial rise (8.5 per cent) in the average size of manufacturing and mining accounts suggests that any decline in the number of firms, whether it arose from business failures, voluntary liquidations, mergers, or from shifts of business concerns out of the District, was largely among the smaller firms.

Public utility, transportation, and communications accounts, a more stable segment of total business demand deposits than manufacturing and mining accounts, increased 8.5 per cent in number; the average size of account decreased by 10.1 per cent, however. Both the number and dollar volume of construction accounts declined, and the combined effect of these two factors was a decline of 7.6 per cent in total dollar balances of such accounts, the largest decline recorded for any ownership group. (Corporate construction accounts increased somewhat in number, though they declined in dollar volume; but noncorporate accounts decreased substantially in both number and dollar volume.)

An increase in the number of trade accounts was reported which was of about the same proportions as the increase in the total amount of such accounts. Consequently, the average size of trade accounts increased only slightly (0.2 per cent).

Accounts of financial enterprises and the accounts of nonprofit organizations both increased in number as well as in total dollar amount. In both cases, however, the average size of account declined (by 2.7 per cent for financial businesses and by 3.4 per cent for nonprofit organizations). The number of accounts belonging to service enterprises and to persons in professional practice decreased slightly, but the average size of account for this group rose 8.6 per cent.

DEPARTMENT STORE TRADE

Second District department store sales in April were over 3 per cent less than in April 1954. The decline appears mainly attributable to the earlier date of Easter this year (April 10, 1955, compared with April 18, 1954). On a seasonally adjusted, daily average basis, and after allowance for the shifting date of Easter, April department store sales in the District are estimated to have approximately equaled April a year ago, though they were down 1 per cent from March. For the first four months of 1955, sales were 1 per cent higher than in the corresponding period of 1954.

Second District department store sales during this year's Easter shopping season (defined as the four weeks before Easter and the two weeks following) were 2 per cent lower than in the Easter season last year. But this year-to-year decline may also be attributed, at least in part, to the earlier date of Easter. Thus, less of the usual spring increase in department store sales came during the Easter season this year than last year, when Easter was a week later. Also, cold weather in late March, and the shifting of the deadline for Federal individual income tax returns from March 15 to April 15 this year, may have caused some purchases of spring apparel to be deferred.

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

Area	Net sales			Stocks on hand Mar. 31, 1955
	Mar. 1955	Jan. through Mar. 1955	Feb. through Mar. 1955	
Department stores, Second District	+ 7	+ 3	+ 3	− 1
New York—Northeastern New Jersey Metropolitan Area	+ 7	+ 3	+ 2	− 1
New York City	+ 5	+ 2	+ 1	+ 1
Nassau County	—	—	—	—
Westchester County	+21	+18	+16	+16
Northern New Jersey	+ 8	+ 3	+ 2	+ 8
Newark	+ 6	+ 1	0	—
Fairfield County	+16	+ 8	+ 8	+ 9
Bridgeport	+15	+ 6	+ 7	—
Lower Hudson River Valley	+20	+13	+13	+ 1
Poughkeepsie	+25	+14	+15	− 3
Upper Hudson River Valley	+ 4	+ 1	0	− 4
Albany-Schenectady-Troy Metropolitan Area	+ 4	0	0	− 3
Albany	+ 9	+ 5	+ 3	− 3
Schenectady	− 1	− 5	− 4	− 6
Central New York State	+ 2	+ 2	0	0
Utica-Rome Metropolitan Area	+ 3	+ 2	0	+ 6
Utica	+ 6	+ 5	+ 4	+13
Syracuse Metropolitan Area	+ 2	+ 2	0	− 3
Northern New York State	+14	+15	+16	+ 5
Southern New York State	+ 5	0	+ 1	− 4
Binghamton Metropolitan Area	+ 9	+ 2	+ 3	− 1
Western New York State	+10	+ 3	+ 5	− 1
Buffalo Metropolitan Area	+10	+ 4	+ 6	− 2
Buffalo	+11	+ 4	+ 6	− 3
Niagara Falls	+ 9	+ 4	+ 2	—
Rochester Metropolitan Area	+ 9	+ 2	+ 4	+ 1
Apparel stores (chiefly New York City)	+11	+ 6	+ 6	+ 1

Comments from retailers in New York City and Newark suggest that they were particularly disappointed with their sales results during the 1955 Easter season. New York City sales were down 3 per cent from 1954, despite vigorous Easter "promotions" by the stores; and in Newark, a 5 per cent decline in sales occurred. These declines are measured from a fairly high base, however, since sales were much better in New York City and Newark than in the rest of the District during the 1954 Easter season.

In the "suburban" part of the New York-Northeastern New Jersey metropolitan area (excluding New York City and Newark) sales during the 1955 Easter season rose by more than 5 per cent over last year. Elsewhere in the District, the Syracuse metropolitan area had a 2 per cent sales gain, this year's sales equaled last year's in the Buffalo metropolitan area, and sales declined slightly (1 per cent) in the Rochester metropolitan area.

Department store sales in New York City and Newark not only lagged behind those in the rest of the District during the Easter season; they have been lagging slightly since the first of the year. In the first quarter of 1955, for example, seasonally adjusted department store sales were 1 per cent higher in New York City and 1 per cent lower in Newark than in the first quarter of 1954. By way of comparison, sales increases up to 3 per cent, on a seasonally adjusted basis, were reported for other cities and metropolitan areas of the District.

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

Item	1955			1954
	Mar.	Feb.	Jan.	Mar.
Sales (average daily), unadjusted	91	81	84	85
Sales (average daily), seasonally adjusted	103	100	106	99
Stocks, unadjusted	114	106	100	116
Stocks, seasonally adjusted	110	109	112	111

SELECTED ECONOMIC INDICATORS
United States and Second Federal Reserve District

Item	Unit	1955			1954	Percentage change	
		March	February	January	March	Latest month from previous month	Latest month from year earlier
UNITED STATES							
Production and trade							
Industrial production*	1947-49 = 100	135*p*	133	132*r*	123	+ 2	+10
Electric power output*	1947-49 = 100	188	186	182	165	+ 2	+14
Ton-miles of railway freight*	1947-49 = 100	—	96*p*	98	87	− 2	+ 7
Manufacturers' sales*	billions of $	—	25.2*p*	24.9	24.1	+ 1	+ 7
Manufacturers' inventories*	billions of $	—	43.6*p*	43.6	45.8	#	− 5
Manufacturers' new orders, total*	billions of $	—	25.7*p*	24.8	22.9	+ 4	+17
Manufacturers' new orders, durable goods*	billions of $	—	12.7*p*	12.1	10.2	+ 5	+32
Retail sales*	billions of $	—	14.8*p*	14.9	13.9	− 1	+ 6
Residential construction contracts*	1947-49 = 100	292*p*	297	288	205	− 2	+42
Nonresidential construction contracts*	1947-49 = 100	234*p*	238	243	182	− 2	+29
Prices, wages, and employment							
Basic commodity prices†	1947-49 = 100	89.2	91.4	91.1	89.8	− 2	− 1
Wholesale prices†	1947-49 = 100	110.0*p*	110.4	110.1	110.5	#	#
Consumer prices†	1947-49 = 100	114.3	114.3	114.3	114.8	#	#
Personal income (annual rate)*	billions of $	—	292.4*p*	291.4	285.0	#	+ 3
Composite index of wages and salaries*	1939 = 100	—	261*p*	261	254	#	+ 3
Nonagricultural employment*	thousands	48,746*p*	48,504*p*	48,445*r*	48,441	#	+ 1
Manufacturing employment*	thousands	16,289*p*	16,129*p*	16,034*r*	16,262	+ 1	#
Average hours worked per week, manufacturing†	hours	40.7*p*	40.4	40.2	39.5	+ 1	+ 3
Unemployment	thousands	3,176	3,383	3,347	3,724	− 6	−15
Banking and finance							
Total investments of all commercial banks	millions of $	81,180*p*	83,640*p*	85,700*p*	75,740	− 3	+ 7
Total loans of all commercial banks	millions of $	72,310*p*	71,180*p*	70,550*p*	67,050	+ 2	+ 8
Total demand deposits adjusted	millions of $	102,410*p*	104,490*p*	107,040*p*	96,970*r*	− 2	+ 6
Currency outside the Treasury and Federal Reserve Banks*	millions of $	30,000*p*	29,964	30,050	30,010	#	#
Bank debits (338 centers)*	millions of $	69,004	67,439	65,248	64,208*r*	+ 2	+ 7
Velocity of demand deposits (338 centers)*	1947-49 = 100	122.5*p*	123.1	121.3	123.8*r*	#	− 1
Consumer instalment credit outstanding†	millions of $	22,974	22,508	22,436	21,381	+ 2	+ 7
United States Government finance (other than borrowing)							
Cash income	millions of $	10,943	6,306	4,299	12,260	+74	−11
Cash outgo	millions of $	6,932	5,481	5,009	6,237*r*	+26	+11
National defense expenditures	millions of $	3,794	3,128	3,273	4,125	+21	− 8
SECOND FEDERAL RESERVE DISTRICT							
Electric power output (New York and New Jersey)*	1947-49 = 100	144	143	142	138*r*	+ 1	+ 5
Residential construction contracts*	1947-49 = 100	—	240*p*	218	195	+10	+22
Nonresidential construction contracts*	1947-49 = 100	—	203*p*	230	191	−12	+15
Consumer prices (New York City)†	1947-49 = 100	112.4	112.5	112.3	112.4	#	#
Nonagricultural employment*	thousands	7,450.3*p*	7,436.1	7,453.1	7,500.7*r*	#	− 1
Manufacturing employment*	thousands	2,585.7*p*	2,568.5	2,578.1	2,667.4*r*	+ 1	− 3
Bank debits (New York City)*	millions of $	63,436	63,434	60,817	64,069	#	− 1
Bank debits (Second District excluding New York City)*	millions of $	4,682	4,489	4,341	4,450	+ 4	+ 5
Velocity of demand deposits (New York City)*	1947-49 = 100	155.3	164.1	159.5	166.0	− 5	− 6

Note: Latest data available as of noon, May 2, 1955.
p Preliminary. *r* Revised.
* Adjusted for seasonal variation.
† Seasonal variations believed to be minor; no adjustment made.
# Change of less than 0.5 per cent.
Source: A description of these series and their sources is available from the Domestic Research Division, Federal Reserve Bank of New York, on request.