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MONEY MARKET IN MARCH

Much of the activity in the money market during March revolved about quarterly Treasury tax collection and debt management transactions. Despite the very large movements of funds occasioned by these operations, and the swings in bank reserve positions resulting from these and other factors, money market conditions remained fairly steady throughout the month. Average member bank borrowings from the Federal Reserve Banks and average net borrowed reserves (member bank borrowings from the Federal Reserve Banks less excess reserves) for the month as a whole were higher than the levels that had prevailed in February, due in large part to increased tightness in the last statement week of March. The effective rate for Federal funds remained at or close to 2½ per cent throughout the month.

Pressure on member bank reserve positions was intensified in the latter part of the month by extraordinary business demands for bank credit partly associated with the tax period. As a result, member bank deposits and required reserves rose sharply; the impact upon net borrowed reserves was accentuated by the effects of Treasury operations and by a substantial decrease in float in the last statement week of the month.

Federal Reserve System security transactions in March consisted largely of short-term repurchase agreements with Government security dealers, until late in the month when moderate amounts of Treasury bills were purchased outright to alleviate month-end strains. On a daily average basis, total System holdings in the week ended March 28 were 73 million dollars larger than in the last week of February. Repurchase agreements served from time to time to relieve temporary stringencies, particularly in the first part of the month and around midmonth; the extensions of Federal Reserve credit to the market in this form were sizable at times, but they were of short duration.

Member bank borrowings from the Federal Reserve Banks remained at substantial levels, approaching 1.2 billion dollars on a daily average basis during the week ended March 28 and averaging above 900 million dollars in each of the preceding two weeks. For the four statement weeks, such borrowings averaged 964 million dollars, compared with 835 million dollars during February and 867 million dollars for the last two statement weeks in January. In general, member banks borrowed from the Federal Reserve Banks during the month in amounts sufficient to offset much of the combined impact upon excess reserves of movements in the operating transactions noted in Table I and of changes in required reserves, rising when these factors depleted excess reserves and falling when they increased them.

The refunding of 8,472 million dollars of 1⅝ per cent Treasury notes maturing March 15 and 1,007 million dollars of 1½ per cent Treasury notes maturing April 1 was successfully completed by the Treasury in the first part of the month, with less than 2 per cent of the maturing securities turned in for cash payment. About 4.5 billion dollars of the 1⅝ per cent notes were held outside the Federal Reserve System; almost half of these were exchanged for new 2⅝ per cent certificates due February 15, 1957 and most of the remainder for additional amounts of the 2⅞ per cent notes originally issued last December and due June 15, 1958. The other 4 billion dollars of the maturing 1⅝ per cent notes and the 1 billion dollars of the 1½ per cent notes due April 1, virtually all of which were held by the Federal Reserve System, were turned in to the Treasury in exchange for the new 2⅝ per cent certificates maturing next February.

Prices of medium and longer-term Government securities tended to fall during most of the month, the decline continu-

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ing a trend that had begun early in February after prices had risen sharply in January. The decline, which gained some momentum as the month progressed, was in part a reflection of increasingly optimistic investor reappraisals of the near-term economic outlook and related expectations of heavy demands upon the capital markets, both of which served to change views held earlier in the year that Federal Reserve policy would be eased in the near future. For the month as a whole, changes in prices of Government bonds and notes maturing through 1959 ranged between increases of ⅛ of a point and declines of about ¾ of a point; prices of longer issues decreased from ⅜ of a point to almost 2 points.

Treasury bill rates were subject to a variety of influences during the month, including demands arising from switches out of "rights" at the time of the refunding, sales by corporations to meet income tax payments, and a demand for issues maturing early in April by banks and others in Cook County, Illinois, for special use over April 1 in connection with local taxes. The average issuing rate established at the weekly auction for Treasury bills rose from 2.173 per cent for bills dated March 8 to 2.374 per cent for the succeeding issue and to 2.422 per cent for the issue dated March 22. Toward the end of the month demand increased, and in the last bill auction of the month, held on March 26 for Treasury bills dated March 29, the average issuing rate fell to 2.173 per cent.

The markets for corporate and municipal bonds developed a marked weakness as the month progressed. Although increased confidence in the business outlook played a part in this trend, the overhang of unsold securities in dealers' portfolios and the heavy and growing capital demands had a more direct influence. There was some price cutting of slowly moving corporate and municipal issues as dealers undertook to move inventories, and yields on previously outstanding securities tended to rise over the month.

Toward the end of the month the leading banks in New York City increased rates from 3¾ per cent to 4 per cent on new loans to customers (excluding Government securities dealers) to carry non-Government securities. Day-to-day rates on loans to Government securities dealers also edged upward, in one instance to the 4 per cent level.

Member Bank Reserve Positions

Member bank reserve positions during March were strongly influenced by the heavy volume of funds that flowed through the banking system as the result of large-scale Treasury tax and debt management operations. Treasury disbursements and collections alternately supplied reserves to or drained reserves from the member banks. Movements in float and required reserves during the month were also of substantial magnitude, and member bank reserve positions frequently showed large variations from day to day.

Net borrowed reserves fluctuated between a low of 262 million dollars on a daily average basis in the statement week ended March 7 and a high of 643 million dollars in the week ended March 28, the highest weekly average of the year thus far. For the month as a whole net borrowed reserves averaged 428 million dollars, which compares with an average of 311 million dollars for the period from mid-January to the end of February.

During most of the first half of the month the Treasury's balance at the Federal Reserve Banks remained fairly stable, but around March 15 it was allowed to decline to relatively low levels in anticipation of forthcoming tax collections. Treasury outlays were enlarged at that time by payments of about 350 million dollars in interest on outstanding securities and by disbursements to cover the maturing securities that had not been tendered for exchange in the refunding operation earlier in the month. As a result, the Treasury's balance at the Federal Reserve Banks dropped from about 561 million dollars on March 14 to 149 million on March 16; by Monday, March 19, however, due to exceptionally rapid processing of incoming corporate tax returns over the week end, the balance had risen temporarily to over 1 billion dollars. Later in the month, on March 22 and 23, the Treasury was called upon to make heavy cash outlays to redeem that portion of two issues of maturing tax anticipation securities which had not been offered in payment against tax liabilities. However, since the Treasury's balance at the Federal Reserve Banks was very large at the start of the week, and heavy tax collections continued to come in, the balance did not approach normal levels

Table I

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, March 1956

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

Factor	Daily averages—week ended				Net changes
	March 7	March 14	March 21	March 28	
Operating transactions					
Treasury operations*	+ 90	− 99	+ 73	−112	− 48
Federal Reserve float	− 45	− 23	+485	−356	+ 61
Currency in circulation	− 22	− 74	+ 12	+ 15	− 69
Gold and foreign account	− 6	+ 22	+ 23	− 6	+ 33
Other deposits, etc	− 19	− 17	− 38	+ 19	− 55
Total	0	−192	+552	−439	− 79
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 42	− 16	− 5	+ 90	+111
Held under repurchase agreements	+ 41	+ 3	+ 8	− 90	− 38
Loans, discounts, and advances:					
Member bank borrowings	− 9	+226	− 41	+262	+438
Other	—	—	—	—	—
Bankers' acceptances:					
Bought outright	—	+ 1	− 1	− 1	− 1
Under repurchase agreements	—	—	—	—	—
Total	+ 74	+213	− 39	+263	+511
Total reserves	+ 74	+ 21	+513	−176	+432
Effect of change in required reserves†	− 24	− 27	−371	+106	−316
Excess reserves†	+ 50	− 6	+142	− 70	+116
Daily average level of member bank:					
Borrowings from Reserve Banks	749	975	934	1,196	964‡
Excess reserves†	487	481	623	553	536‡

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

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for four weeks ended March 28.

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until late in the month. In an effort to moderate the impact of its operations upon member bank reserve positions, the Treasury frequently used its special call or redeposit facilities with the Class C depositaries.

Float generally rises at midmonth, and the March rise has normally been larger than that of most other months due to the congestion created by the heavy flow of tax checks. But this year the increase was greater than usual, as snow storms over the northeastern part of the country interfered with air mail deliveries and delayed the processing of checks. Thus the daily average level of float rose from 812 million dollars in the week ended March 14 to 1,297 million dollars in the following week, as the effect of the usual midmonth rise was compounded by the inclement weather. The peak increase in float partially coincided with the major increase in the Treasury's balance at the Federal Reserve Banks, so that daily movements in these factors within the week ended March 21 tended to offset each other with respect to their effect on member bank reserve positions. During the following week, both float and the Treasury balance were reduced substantially.

Business borrowing for tax and other purposes resulted in large deposit increases for member banks during the month, with consequent increases in required reserves. The daily average level of required reserves rose 371 million dollars in the week ended March 21 over the level of the previous week, one of the largest weekly increases on record for a period when no Treasury borrowing of new money took place. In addition, reserve positions were affected by a volume of currency in circulation which remained considerably larger than normal for the month of March, possibly due to the early Easter date of April 1 this year.

The Government Securities Market

On March 1 the Treasury announced refunding terms for 8,472 million dollars of 1⅝ per cent notes due March 15 and 1,007 million dollars of 1½ per cent notes due April 1. Holders of the 1⅝ per cent notes were given the option of exchanging them for a new 2⅝ per cent certificate maturing February 15, 1957 or for an additional amount of the outstanding 2⅞ per cent notes, originally issued December 1, 1955, which mature June 15, 1958. Holders of the 1½ per cent notes of April 1 (principally the System Open Market Account) were offered an exchange only into the new 2⅝ per cent certificates. The effective date of the exchange was March 5, with interest adjustments made as of that date, and a delivery date of March 15. Subscription books were open March 5 through March 7.

Following the Treasury's announcement of the refunding terms, the maturing 1⅝ per cent notes were bid above par through the close of the market on March 7, and the premium bid for these maturing notes encouraged a number of holders who required cash for current needs to sell rather than redeem their holdings at maturity. Holders of less than 2 per cent of the maturing notes retained their holdings for cash redemption rather than accepting the new securities offered in exchange; investors subscribed for 7¼ billion dollars of the new 2⅝ per cent certificates (including 5 billion for the Federal Reserve Banks) and 2.1 billion of the reissued 2⅞ per cent notes. The percentage of attrition on the refunding was the smallest in more than a year. The new certificates and reissued notes both traded at from 1/16 to ⅛ above par on a "when-issued" basis until the delivery date. Shortly thereafter the general softness of the market brought the notes down to slightly below par, but the new certificates maintained a premium through the end of the month.

Government security prices generally tended to fall during the month. The decline in prices was accompanied by occasional liquidation of intermediate and long-term issues by institutional investors and some commercial banks, and the lower price levels may also have caused some revival of tax switching. Bonds and notes were particularly affected by the heavy volume of new corporate and municipal offerings in prospect and by the increased investor confidence in the business outlook. These influences tended to dampen the earlier view that Federal Reserve policy might change in the direction of less credit restraint in the near future. This reappraisal was reinforced by strong upward movements in stock prices, the findings of the Department of Commerce and Securities and Exchange Commission survey of business plans for expenditures on new plant and equipment, and the preliminary results of the Federal Reserve System-sponsored survey of consumer intentions, suggesting continued high consumer spending. On balance, prices of bonds and notes maturing from 1960 through 1972 fell by ⅜ to 1 15/16 points for the month as a whole, to about the level that had prevailed early last August. The 3¼ per cent bonds of 1978-83 dropped 1⅞ points in price during the month to close at 103 13/16 (bid), a yield of 3.02 per cent, and the 3's of 1995 moved downward from 100 9/16 (bid) at the start of the month to close on March 29 at 98⅞, the lowest they have been since last August 29. Recurrent rumors in the market that the 3's might be reopened for an additional offering by the Treasury in the next few months were in part responsible for the initial phase of their price decline.

Treasury bill yields fell sharply early in the month as a result of strong bank and nonbank demand arising partly from switching out of "rights" in connection with the Treasury's refunding. The longest outstanding issue fell 24 basis-points from 2.30 per cent (bid) at the start of the month to 2.06 per cent on March 2, but then returned to 2.37 per cent by midmonth as corporations sold bills to raise funds needed for the March 15 tax date. The demand for Treasury bills then increased and yields fell from their midmonth levels; the yield on the longest outstanding issue of Treasury bills fell to 2.13 per cent (bid) by March 26, but then rose again to close the month at 2.30 per cent, the same as it had been at the start of the month. The yields on the first two issues maturing in April remained well below those on other maturities through-

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out much of the month, due to strong demand arising from Illinois investors seeking to reduce their demand deposits prior to the April 1 Cook County personal tax assessment date.

Other Securities Markets

The market for new issues of corporate and municipal securities exhibited weakness and congestion in March and was marked by sagging prices in the face of a large overhang of recent municipal bond flotations and a heavy March volume of corporate offerings. As the month progressed, increasingly widespread price concessions were offered to facilitate distribution of slow-moving issues. These developments were accompanied by an increase of 7 basis-points in average yields on seasoned Aaa-rated corporate bonds and of 16 basis-points on long-term Aaa municipal bonds, as reported by Moody's Investors Service. The Dow-Jones average of revenue bond yields registered a rise of 9 basis-points in March.

The estimated volume of publicly offered municipal bonds in March declined to about half of the heavy volume of February, as several expected issues were delayed in the face of rising rates and the congestion resulting from considerable unsold amounts of recent issues. Dealers' inventories continued to rise through the middle of the month, but declined slightly in the latter half as underwriting syndicates were broken up and unsold securities were reduced in price. The unsold balances of two large toll-road bond issues were repriced during March to yield as much as 20 basis-points more than the initial offerings in February.

In contrast to the marked decline in the volume of new municipal issues, public offerings of corporate bonds for new capital rose from 120 million dollars in February to an estimated 380 million dollars in March. As the month progressed several underwriting syndicates were dissolved and offering prices were reduced, as dealers attempted to market the heavy volume of new issues. Toward the end of the month a reoffering yield of 3.35 per cent was designated by a syndicate of investment bankers on a new Aaa-rated utility issue, the highest rate since 1953 on such an offering.

Member Bank Credit

Total loans and investments of weekly reporting member banks increased 2,417 million dollars during the four-week period ended March 21, with total loans rising 2,092 million dollars and investments increasing 325 million dollars. Commercial and industrial loans increased 1,510 million dollars to account for the bulk of the loan expansion; the rise of 592 million dollars in these loans during the week ended March 14 and of 681 million in the week ended March 21 represented the largest weekly increases in such loans since the week ended June 15, 1955, which also included a quarterly tax payment date. A substantial part of the rise in business loans in these weeks presumably represented borrowing by the nation's larger corporations to raise funds to meet the March 15 tax payment date. Of the total increase of 1,273 million dollars in the two weeks, 763 million occurred at reporting New York City banks.

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. 28, 1955 to Mar. 21, 1956
	Feb. 29	Mar. 7	Mar. 14	Mar. 21	
Assets					
Loans and investments:					
Loans:					
Commercial and industrial loans	+ 89	+148	+ 592	+ 681	} +1,038
Agricultural loans	− 14	− 10	+ 1	− 17	
Security loans	+ 17	+ 44	+ 89	+ 183	− 98
Real estate loans	+ 30	+ 30	+ 33	+ 33	+ 173
All other loans (largely consumer)	+ 84	+ 9	+ 32	+ 50	+ 191
Total loans adjusted*	+200	+220	+ 741	+ 931	+1,200
Investments:					
U.S. Government securities:					
Treasury bills	− 38	−147	+ 224	+ 126	− 422
Other	− 85	+ 32	+ 50	+ 97	−1,046
Total	−123	−115	+ 274	+ 223	−1,468
Other securities	+ 41	+ 43	− 4	− 14	+ 21
Total investments	− 82	− 72	+ 270	+ 209	−1,447
Total loans and investments adjusted*	+118	+148	+1,011	+1,140	− 247
Loans to banks	+143	+ 61	− 79	− 123	− 29
Loans adjusted* and "other" securities	+241	+263	+ 737	+ 917	+1,221
Liabilities					
Demand deposits adjusted	+125	+187	+1,186	−1,103	−2,382
Time deposits except Government	+ 41	+ 17	+ 87	− 2	− 66
U. S. Government deposits	+232	−675	− 109	+2,344	+1,711
Interbank demand deposits:					
Domestic	− 90	+445	+ 199	− 367	− 902
Foreign	− 5	+ 34	+ 1	− 30	− 5

* 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.

During the first twelve weeks of 1956 business loans increased 1,038 million dollars at the weekly reporting member banks, compared with a net increase of 214 million dollars in the corresponding period a year ago. The borrower categories largely responsible for the increase were metals and metal products firms, public utility and transportation companies, and petroleum, coal, chemicals, and rubber producers. Sales finance companies reduced their bank loans 328 million dollars during this period, while in the similar period last year they increased these borrowings by 87 million dollars. Thus business loans, exclusive of loans to sales finance companies, increased 1,366 million dollars this year, compared with an increase of 127 million dollars during the corresponding period in 1955.

Reporting member bank holdings of Treasury bills increased substantially in the weeks ended March 14 and March 21; for the four weeks through March 21 total holdings of Government securities were increased 259 million dollars. From the beginning of the year, total investments had fallen 1,447 million dollars, as compared with a drop of 2,987 million in the like weeks last year.

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INTERNATIONAL MONETARY DEVELOPMENTS

Monetary Trends and Policies

During March, the monetary authorities of several foreign countries took new measures of credit restraint or reinforced measures taken previously.

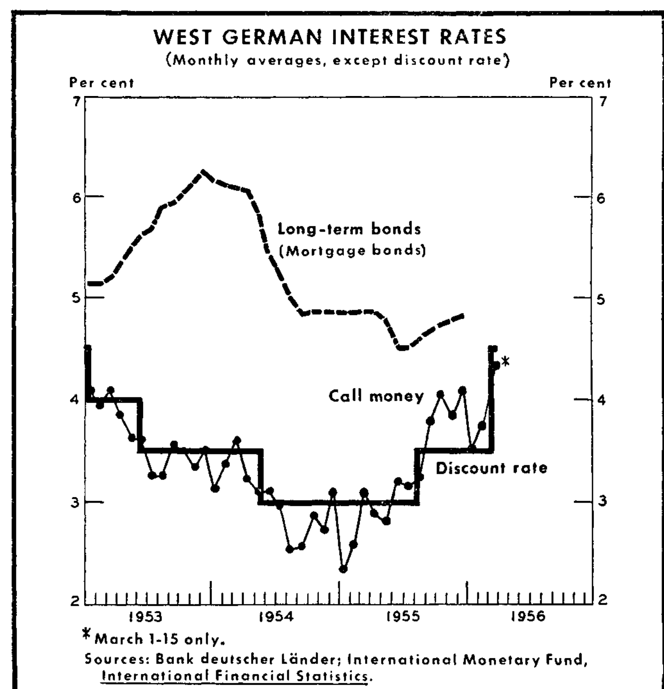
In West Germany, the Bank deutscher Länder on March 8 raised its discount rate to 4½ per cent from 3½ (see chart). The rate had been raised to 3½ from 3 last August, following five previous reductions; in August the central bank had also increased the commercial banks' reserve requirements. The discount rate was raised last month against the background of booming business activity. Industrial production last year was 16 per cent above 1954 and more than double the 1936 output. While wholesale prices increased by 2.6 per cent during 1955, the cost of living, after having declined during the first half of the year, rose by 2.8 per cent during the second half, and since the year end there have been further price rises in some important groups of consumer goods. Wages in certain major industries have recently been increased; coal miners, for example, have received wage raises averaging 9 per cent. On the external side, Germany continues to register an over-all balance-of-payments surplus although, at some 450 million dollars' equivalent, the 1955 surplus was lower than the 670 million and 900 million recorded in 1954 and 1953. The measures of monetary restraint adopted by the Bank deutscher Länder last summer had brought about a general money market tightness which, in turn, had caused increased recourse to the central banking system on the part of the credit institutions, as well as a slow rise in short-term interest rates. Toward the close of the year, the day-to-day money rate generally had fluctuated above the prevailing discount rate, and while some easing subsequently took place, during most of February the rate once more ranged above the old 3½ per cent discount rate level.

In the United Kingdom, the Treasury reduced from £50,000 to £10,000 the amount of new stock and bond issues that may be floated annually by any company without the authorization of the Capital Issues Committee. This move was said to have been made to extend the scrutiny of the committee to a sector of the capital market hitherto free of restrictions, and reinforces the Chancellor of the Exchequer's request, made in the course of the mid-February restraint measures, that the Capital Issues Committee adopt a "vigorously critical attitude" toward new issues. The Treasury also announced higher interest rates for new loans to local authorities by the Public Works Loan Board, the second such increase this year. The rate for loans up to five years was raised from 5½ to 5⅝ per cent, and for loans exceeding five years from 5⅜ and 5¼ to a uniform 5½ per cent; it appears that the board's rule not to make loans for periods of less than seven years remains in force.

In anticipation of the increase in the Treasury's seasonal cash deficit following the period of heavy tax collections, as well as of the August refunding of 2½ per cent National War Bonds, a 300 million pound issue of 5 per cent Exchequer Stock maturing June 15, 1957 was offered at par on March 7. According to market reports, over two thirds of the issue had to be taken up by government departments, in part because of the concurrent rise in long-term government security yields. The yield of 2½ per cent Consols, which at the end of February had stood at 4.51 per cent, on March 13 reached 4.74 (exceeded in the postwar period only by the mid-February level of 4.75), but closed at 4.65 on March 29. The average tender rate for three months' Treasury bills, which had soared to 5.27 per cent following the February 16 discount rate increase, dropped to 5.11 by the fourth March tender. The latest quarterly Analysis of Advances by members of the British Bankers' Association shows that, in the quarter ended in mid-February, advances declined by only 20 million pounds (as against a 235 million decline in the preceding three months), primarily because increases in advances to the engineering and other industries partly offset repayments by the nationalized utilities.

In Ireland, where the central bank discount rate was raised last December, the authorities introduced controls over most hire-purchase sales, in the form of minimum downpayments and maximum repayment periods, with commercial vehicles and agricultural and industrial machinery the major exceptions. In addition, in order to counteract the country's growing balance-of-payments deficit, a special import levy resulting in most cases in a 25 per cent rise in import prices was imposed.

In Canada, the interest rate ceiling on government-insured housing loans granted by banks and insurance companies was



*March 1-15 only.
Sources: Bank deutscher Länder; International Monetary Fund, International Financial Statistics.

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raised from 5¼ to 5½ per cent. Total loans by the chartered banks on March 7 reached a new peak, 24 per cent above a year earlier. The shift in the composition of the chartered banks' holdings of government securities, from long-term bonds to Treasury bills, continued during March; this was presumably in preparation for the coming into effect next month of secondary commercial bank reserve requirements in the form of Treasury bills and call loans, as agreed upon informally between the Bank of Canada and the chartered banks. Long-term interest rates edged upward once more during the first half of March, while the three months' Treasury bill tender rate rose on March 16 to 2.62 per cent, the highest level since early December.

A series of anti-inflationary measures announced in Australia included extensive increases in indirect taxes, such as excise and customs duties, but did not entail any increases in personal taxes or additional import or credit restrictions; existing credit restrictions, the Prime Minister declared, had gone as far as they "reasonably could". The new measures were, however, accompanied by an over-all increase in officially controlled interest rates. It was announced that trading-bank overdraft rates would be allowed to rise from 5 per cent to an average of 5½, with a maximum of 6 per cent; interest rates on time deposits will rise by 1 per cent. Earlier in March the central bank reportedly had withdrawn its support of the bond market, allowing the long-term bond yield to rise from 4½ to 5 per cent.

In New Zealand, commercial bank cash reserve requirements against demand liabilities were lowered sharply on February 29 to 7 per cent from 26, while minimum requirements against time deposits were reduced to 3 per cent from 7½. The Reserve Bank emphasized that this was an adjustment that was "purely temporary", in anticipation of the period when increased tax payments normally entail a substantial reduction in the trading banks' cash balances with the central bank. An increase in the ratios was understood to be contemplated "in a few weeks" in order to insure maintenance of the existing degree of credit restraint. The continuance of tightness in the money and capital markets is evidenced by the higher rates on time deposits paid by the trading banks since mid-February (with the new rates ranging from 1½ to 2½ per cent as against the previous ¾ to 2 per cent in force since 1941), as well as by a ½ per cent increase to 4¾ per cent in the maximum interest rate on loans to local authorities. According to an announcement by the Finance Minister, the government also will pay higher interest rates on some conversion issues later this year.

From some of the countries with less highly developed monetary and banking systems, various measures of monetary policy likewise have been reported since the beginning of 1956. In Chile, the authorities have reinforced the existing limits on the expansion in bank lending by introducing a sliding-scale discount rate structure, under which the banks may borrow at the basic 4½ per cent rate from the central bank only up to the equivalent of half their combined capital and reserves at the end of 1955; for borrowing in excess of this amount, the rate may rise as high as 9 per cent. In Ceylon, in view of the high liquidity of the economy, the central bank placed on the market its own one-year 1¼ per cent and two-year 1¾ per cent securities, to a total of 10 million rupees, while the government simultaneously floated two development loans totaling 50 million rupees. In India, the Reserve Bank raised the rate on advances to banks under the Bill Market Scheme from 3 per cent to 3¼, effective March 1, thus narrowing to ¼ per cent the gap between this rate and the discount rate.

Exchange Rates

Sterling was under considerable pressure during March 1-6, after which it made some recovery but failed to regain the higher quotations at the month's opening. The Canadian dollar continued relatively stable in a rather quiet market.

Rates for sterling moved substantially lower during the first week of the month, as increased demand for dollars in London and additional supplies of sterling in New York tended to produce weakness in a market made uneasy by Near East political developments. At the same time, the market appeared relatively unaffected by the announced increase of 61 million dollars in Britain's gold and dollar reserves during February. American-account sterling thus declined from its February close of $2.80 31/32 to as low as $2.80 7/32 on March 6, the lowest quotation since last December. Transferable sterling, although generally in better demand, also declined during this period but only by ½ cent to $2.7720.

After March 6, sterling recovered a considerable part of the ground lost earlier, with American-account sterling moving as high as $2.80¾ on March 20. Covering of short positions in the market reportedly accounted for the initial strengthening of rates, following which the announcement of Britain's low trade deficit during February and fair commercial demand for sterling brought added firmness to the rates. As the Easter holiday week end approached, however, rates again fell off sharply, with American-account sterling closing at $2.80 13/32 on March 30. Transferable sterling, after moving upward to $2.78, also declined at the month's end to close at $2.7785. Sterling for forward delivery moved to wider discounts during March, with relatively heavy forward sales carrying three and six months' sterling to discounts of 2 1/16 and 3 13/16 cents, respectively. Securities sterling rose sharply during the month, with the quotation moving from $2.74⅜ to $2.78.

The Canadian dollar remained quite steady throughout most of the month, with no sustained pressures evident and with quotations ranging from $1.00 1/16 to $1.00 7/32. At the month's end, however, the rate tended to weaken somewhat as the result of fair commercial demand for United States dollars in Canada.

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COMMERCIAL BANKS IN THE MORTGAGE MARKET

Although commercial banks have participated in real estate financing for many years, their activities in this field have attained new importance since the end of World War II. Commercial bank holdings of real estate loans rose from 4.8 billion dollars in 1945 to 21.2 billion at the end of 1955. On the latter date, such loans constituted 10 per cent of the total assets of commercial banks and 16 per cent of the total mortgage debt outstanding. In addition, commercial banks held several hundred million dollars of unsecured construction loans, and were providing indirect real estate financing to the extent of about 1.2 billion dollars advanced to other real estate lenders[1] and about 650 million dollars advanced to the Federal Home Loan Banks and the Federal National Mortgage Association (FNMA)[2] through the purchase of their securities.

About three fourths of the dollar volume of commercial bank real estate loans outstanding are residential. Only a small proportion (about 6 per cent) are farm loans, while the remaining 18 per cent are mostly loans secured by commercial structures. These proportions correspond very closely with the composition of the total United States mortgage debt outstanding, and commercial banks consequently hold about 16 per cent of each of the main categories of mortgages. Within the residential group, however, there are significant differences. Thus, about 6 per cent of all the residential loans held by commercial banks are on multifamily properties, compared with 11 per cent in the case of all other lenders.[3] Moreover, 52 per cent of the residential mortgages held by commercial banks are Federally underwritten, compared with 41 per cent of the mortgages held by other lenders.

Real estate loans bulk more importantly in the portfolios of country banks than in the portfolios of banks located in the larger cities, owing in the main to the greater relative importance of time deposits in country bank liabilities. A smaller proportion of the country banks' real estate loans is Federally underwritten than is the case for city banks.

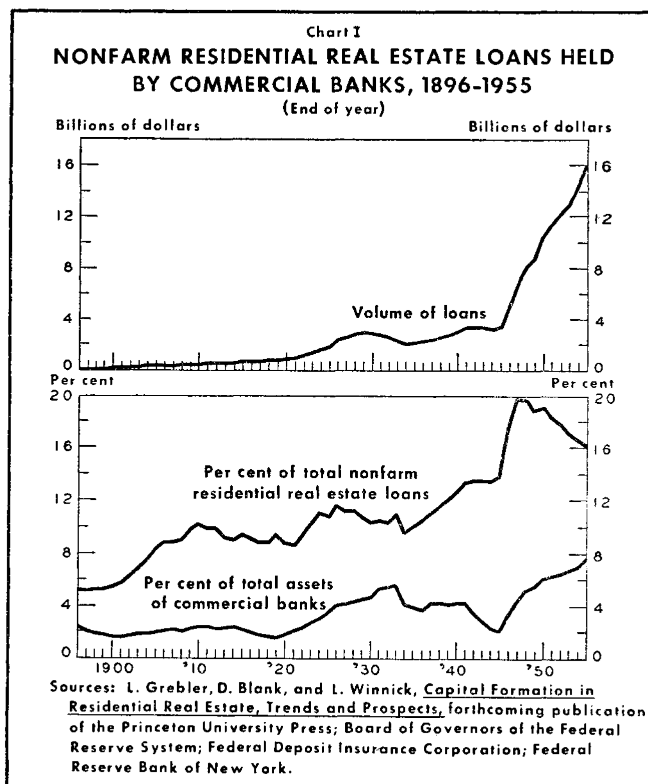
TRENDS IN COMMERCIAL BANK REAL ESTATE LENDING

Since the turn of the century the relative importance of commercial banks in the market for nonfarm residential mortgages has tended to increase markedly. Their share of the total volume of such mortgages outstanding rose from less than 6 per cent in 1900 to a historical high of 20 per cent in 1947 and 1948 (see Chart I). By the end of 1955, the proportion had declined to about 16 per cent.

To a great extent, the forces responsible for this long-run growth are general and pervasive, affecting the other major types of financial institutions as well as commercial banks. Thus, commercial banks, savings and loan associations, mutual savings banks, and life insurance companies combined increased their share of the total nonfarm residential mortgage debt from about 47 per cent to 84 per cent between 1896 and 1954, while the share held by individuals and other institutions fell correspondingly.[4] The relatively rapid growth of commercial bank resources also has been an important factor contributing to the increase in their share of mortgage debt. In addition, commercial banks have been placing a larger proportion of their total resources in mortgages. Nonfarm residential mortgages comprised 7.6 per cent of total commercial bank assets at the end of 1955, whereas the highest prewar ratio was 5.5 per cent (in 1933). This ratio averaged only about 2 per cent between 1896 and 1924.

There are several reasons for the increasing importance of mortgages in commercial bank portfolios. First, there has been a progressive liberalization of legal restrictions on real estate lending by national banks. Prior to 1916, these banks were prohibited altogether from making loans on urban real estate;

Chart I
NONFARM RESIDENTIAL REAL ESTATE LOANS HELD BY COMMERCIAL BANKS, 1896-1955
(End of year)



Sources: L. Grebler, D. Blank, and L. Winnick, Capital Formation in Residential Real Estate, Trends and Prospects, forthcoming publication of the Princeton University Press; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Federal Reserve Bank of New York.

[1] Unsecured construction loans and loans to real estate lenders which are either unsecured or secured by the pledge of mortgages owned by the borrower are not classified as real estate loans in bank condition statements. Secured construction loans (the volume of which is not known) and about 300 million dollars of loans purchased from real estate lenders under resale agreement are included in the 21.2 billion total for bank-held mortgage loans at the end of 1955.

[2] The activities of the FNMA were discussed in the December 1955 issue of the *Monthly Review*, in an article entitled "FNMA in the Postwar Mortgage Market".

[3] However, commercial banks do a substantial business in the originating of mortgage loans on multifamily structures. Most of these mortgages are subsequently sold.

[4] *Capital Formation in Residential Real Estate, Trends and Prospects* by L. Grebler, D. Blank, and L. Winnick, forthcoming publication of the Princeton University Press, and *Annual Report of the Housing and Home Finance Agency, 1954.*

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in that year they were granted such authority but the maximum maturity allowable was only twelve months. By 1927, national banks had acquired only about 900 million dollars of nonfarm mortgages constituting about 3 per cent of their assets (Table I). In contrast, other commercial banks, faced generally with less restrictive laws, held 4.2 billion dollars of nonfarm mortgages comprising 12 per cent of their assets.

The maximum maturity on conventional mortgage loans made by national banks was extended to five years in 1927 and to ten years in 1935. Each of these changes encouraged more active participation by these banks in the urban real estate market. By the end of 1954, the latest date for which data are available, nonfarm mortgages constituted almost as large a proportion of total assets for national banks as for other commercial banks. The maximum maturity was further extended to twenty years in 1955.

A second factor which has induced commercial banks to invest a larger proportion of their assets in mortgages has been the development of the Federal Housing Administration (FHA) program, and later the Veterans Administration (VA) program. Federally underwritten loans have been exempt from restrictions imposed on commercial banks with respect to maximum loan-to-value ratios and maximum maturities. Moreover, the insured or guaranteed mortgage is more marketable than the conventional mortgage, an important consideration to commercial banks.

The increasing importance of mortgages in commercial bank portfolios may also reflect changes in the composition of their other assets. Government securities have accounted for a larger proportion, and loans (other than real estate loans) for a smaller proportion, of total bank assets in recent years than at any time prior to World War II. The added liquidity associated with this shift may have encouraged banks to invest more heavily in mortgages. As indicated below, this was probably an important influence on real estate lending policies in the early post-World War II period.

Post-World War II Mortgage Lending

Commercial banks were more active in the mortgage market in the early postwar period than during any previous period in their history. Their holdings of nonfarm mortgage debt rose from 4.3 billion dollars at the end of 1945 to 10.0 billion dollars at the end of 1948. This 5.7 billion dollar increase constituted 28 per cent of the total net increase in such mortgages and raised the commercial banks' share of total nonfarm mortgages outstanding from 14 per cent to 20 per cent (Table II). Commercial banks also accounted for about one fourth of all the loans made on small properties (as measured by mortgage recordings of $20,000 or less) in these years.

The rapid increase in commercial bank mortgage portfolios during 1946-48 suggests that, under some circumstances, factors influencing the composition of bank assets may be a more important determinant of the amount of bank real estate lending than changes in total bank resources. Commercial bank assets declined by 5.6 billion dollars in this period, while the combined assets of insurance companies, mutual savings banks, and savings and loan associations increased by 18.5 billion dollars. Nevertheless, there were powerful forces tending to encourage increased real estate investment by commercial banks.

First, although total commercial bank deposits fell by 7.4 billion dollars between December 31, 1945 and December 31, 1948, time deposits (of individuals, partnerships, and corporations) rose by 5.1 billion dollars. Although banks usually do not segregate their investment of funds on the basis of the sources from which these funds are derived, they tend to be influenced by the general principle that it is more appropriate to make real estate loans with funds obtained from time deposits than with funds obtained from demand deposits.[5]

Second, at the end of 1945 commercial banks held over 90 billion dollars of United States Government obligations, constituting almost three fourths of their earning assets. In view

[5] Under the laws relating to national banks, real estate loans are limited to 60 per cent of the time deposits of a bank, or 100 per cent of capital and unimpaired surplus, whichever is larger.

Table I

Nonfarm Mortgage Holdings of National and Other Commercial Banks
(Dollar amounts in billions)

End of year	All commercial banks		National banks		Other commercial banks	
	Amount	Per cent of assets	Amount	Per cent of assets	Amount	Per cent of assets
1927	5.1	8	0.9	3	4.2	12
1935	3.0	6	1.1	4	1.9	8
1945	4.3	3	2.0	2	2.3	3
1954	17.5	9	9.4	8	8.1	9

Sources: Annual reports of the Comptroller of the Currency; *Capital Formation in Residential Real Estate, Trends and Prospects* by L. Grebler, D. Blank, and L. Winnick, forthcoming publication of the Princeton University Press; *Federal Reserve Bulletin*.

Table II

Nonfarm Mortgage Recordings and Net Increases in Nonfarm Mortgage Debt for Commercial Banks and All Lenders
(Dollar amounts in billions)

Year	Mortgage recordings*			Net increase in nonfarm mortgage debt		
	All lenders	Commercial banks		All investors	Commercial banks	
		Amount	Per cent of total		Amount	Per cent of total
1946	10.6	2.7	26	6.1	2.3	38
1947	11.7	3.0	26	7.0	2.1	30
1948	11.9	2.7	23	7.0	1.4	20
Annual average 1946-48	11.4	2.8	25	6.7	1.9	28
1949	11.8	2.4	20	6.2	0.7	11
1950	16.2	3.4	21	9.6	2.0	21
1951	16.4	3.4	21	8.9	1.0	11
1952	18.0	3.6	20	8.4	1.1	13
1953	19.7	3.7	19	9.4	1.0	11
1954	23.0	4.2	18	12.0	1.6	13
1955	28.5	5.6	20	15.7	2.4	15
Annual average 1949-55	19.1	3.8	20	10.0	1.4	14

* Limited to recordings of $20,000 or less.

Source: *Federal Reserve Bulletin*.

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of the policy which prevailed at that time of supporting the prices of Government securities, commercial banks probably felt they had a superfluity of liquidity and that they could safely acquire less liquid mortgages.

Third, from the point of view of yield, mortgages were a relatively attractive investment. Whereas the longest-term Government bonds yielded less than 2½ per cent, the interest rate on Federally underwritten mortgages was 4 to 4½ per cent.[6]

The major readjustment in commercial banks' portfolios seems to have been largely completed by the end of 1948. At that time many banks probably had reached their immediate goals for mortgage holdings. Moreover, with bond yields having risen moderately from their 1946 lows, the yield advantage of mortgages had been reduced. In 1948 the rate of increase in commercial bank mortgage holdings declined substantially. Liquidation of Government securities (which reduced holdings by almost one third in the three years) came to at least a temporary halt by early 1949.

During the period 1949-55, the growth in commercial bank holdings of mortgages continued, but the increase accounted for only 14 per cent of the total increase in nonfarm mortgage debt, compared with 28 per cent during 1946-48. Their share of mortgage recordings in this period was 20 per cent, compared with 25 per cent in the early postwar period. The smaller decline in the banks' share of total mortgage recordings than in their share of net debt increase suggests a shift in emphasis from permanent to temporary financing. Short-term construction loans probably constituted a larger proportion of bank real estate loans in the 1949-55 period, as loans on newly constructed dwellings increased in importance relative to loans on existing properties. It is also likely that sales of real estate loans by banks were more important than before. For example, FHA records show that banks were net purchasers of FHA mortgages in 1946 and 1947 and net sellers in every subsequent year. Finally, as described below, "warehousing" loans to real estate lenders came into prominence in 1954 and 1955.

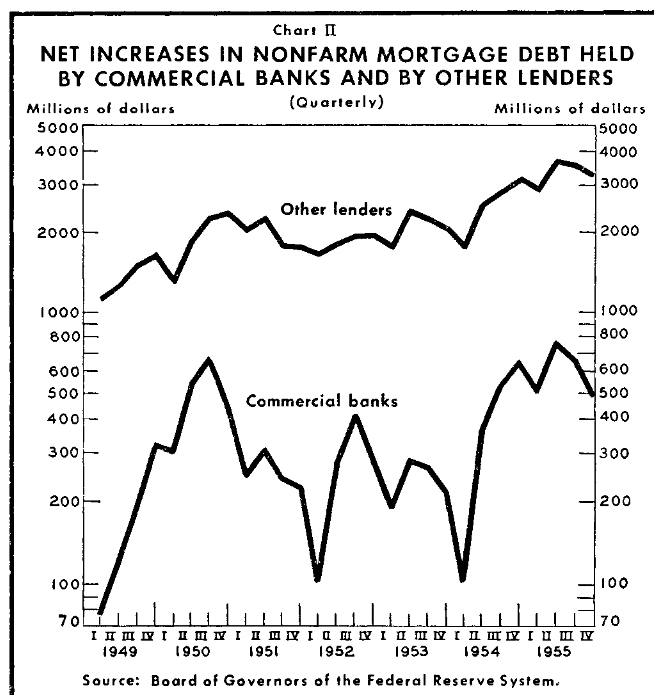
Although the tendency during the years 1949-55 was for commercial banks to absorb a declining share of the increase in total mortgage debt outstanding, the share of the banks varied considerably from year to year. After falling to 11 per cent in 1949, this share rose to 21 per cent in the boom year of 1950 and then fell again in subsequent years. However, in 1955 the net increase in commercial bank nonfarm mortgage holdings was 2.4 billion dollars, which was more than in any previous year; this constituted 15 per cent of the total net increase, or the highest proportion since 1950.

Quarterly data on holdings of nonfarm mortgage debt (available since 1949) indicate that changes in the holdings of commercial banks have fluctuated more than changes in the holdings of other mortgage lenders (Chart II). It is likely that because of their liquidity requirements the mortgage investment goals of commercial banks shift more markedly and more quickly than those of "savings" institutions. Commercial banks may also act as a residual source of mortgage financing, with their holdings tending to increase most rapidly when the demand for mortgage funds exceeds the capacity of savings institutions.

Mortgage Warehousing in 1954 and 1955

Toward the end of 1954 and early 1955, there were reports that commercial banks were channeling an unusually large volume of short-term credit into the mortgage market in the form of loans to real estate lenders. Special surveys undertaken by the Board of Governors of the Federal Reserve System indicated that a marked expansion of such lending had indeed taken place. From a total of about 600 million dollars in August 1954, the volume of such loans at weekly reporting member banks had risen to 1,600 million by November 1955. In the following months the volume declined somewhat, falling to about 1,400 million in February of this year.

Warehousing loans can be divided into three general types. The first type is the "committed-interim" warehousing loan which banks have been making for many years. Such a loan is made to a mortgage or real estate company having limited resources. Its purpose is to provide financing for the lender between the time he must make payment to the builder (for the account of home purchasers) and the time he can deliver



[6] These were the maximum allowable rates which in most cases are also the actual rates. To make these rates comparable to bond yields, servicing and other costs must be deducted. A common rule of thumb used in the trade is that such costs amount to about 80 basis-points.

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completed mortgages to a final investor who had previously contracted to purchase them. The duration of such a loan is limited to the period which the real estate lender needs to complete the legal and administrative details incident to the preparation of a complete mortgage "package"—generally not more than six months. The provision of short-term credit of this type facilitates an efficient division of functions between the real estate company and the savings institution. Since the take-out commitment by the savings institution assures that long-term funds have been earmarked for the transaction, there is no expansion of mortgage investment by this institution beyond the limits imposed by its currently available funds. Loans of this type probably did not account for a very large proportion of the total increase in warehousing loans in 1955.

A second type of warehousing loan—the "uncommitted-interim" loan—is identical to the first type except that no take-out commitment from a permanent investor exists at the time the loan is made. During periods of market uncertainty, when investors become unwilling to make forward commitments except at prices substantially below the prevailing price on mortgages for immediate delivery, short-term credit of this sort may provide added continuity to the market. In the absence of a take-out commitment, banks seek to protect themselves by limiting advances to an amount less than the market value of comparable mortgages available for immediate delivery. However, lending of this type involves the possibility that, due to miscalculation or to a sudden weakening in the market, banks will suddenly find themselves holding more mortgages than they wish.

A third type of warehousing loan, which first came into prominence in late 1954 and 1955 as a result of several large individual transactions, can be called "committed-institutional" warehousing. Such loans are made directly to large institutional investors rather than to real estate or mortgage companies and are designed to augment temporarily the institutions' customary sources of funds. The growth of this type of warehousing in 1955 permitted investors to make mortgage loans exceeding their current net accrual of funds by anticipating their future inflow of funds. The duration of such loans is not limited to the period required to complete a "technical" process as is customary in the case of interim loans to real estate or mortgage companies. Typical transactions have involved maturities of twelve or eighteen months, with the borrower having the option of paying sooner. Such loans thus involve a longer-term extension of commercial bank credit than the "committed-interim" type of warehousing arrangement.

Summary

Although real estate loans constitute a relatively small proportion of the total assets of commercial banks, this proportion has been tending upward for many years in response to more liberal legislation pertaining to bank real estate lending, to the development of the FHA and VA programs, and to shifts in the composition of the banks' other assets. The volume of bank real estate lending reached new highs in the post-World War II period. The share of total outstanding mortgages held by commercial banks was at a peak in the years 1946-48, when banks appeared to be making a major adjustment in their portfolios. Although the banks' share has declined somewhat since then, it is still considerably higher than at any time prior to 1946. There has also been some tendency since the early postwar years for temporary real estate financing by banks to increase in importance relative to permanent financing. This shift was especially noticeable in late 1954 and 1955, when banks channeled an increased volume of funds into the mortgage market in the form of warehousing loans to other real estate lenders.

MONETARY POLICY IN LATIN AMERICA

During recent years there has been a growing awareness in most Latin American countries of the importance and usefulness of monetary policy in promoting internal and external stability as well as balanced and orderly economic development. With these as the principal aims, no fewer than nine of the twenty Latin American republics since 1945 have either established new central banks or thoroughly reorganized their existing ones.[1] At the same time, the Latin American monetary authorities have made increasing and more flexible use of the available credit-control instruments. In addition, many of the countries have taken steps to overcome certain institutional and economic obstacles that have long impeded the effective application of monetary policy.

[1] These countries are Chile, Colombia, Costa Rica, Cuba, the Dominican Republic, Ecuador, Guatemala, Honduras, and Paraguay.

Economic and Financial Setting

Perhaps the most important of these obstacles has been the general lack of organized and integrated money and capital markets. In many of the countries, low personal incomes have severely restricted the volume of savings and investment; moreover, such investment as has taken place has in large part gone into real estate and inventory holdings, while investor interest in corporate and government securities has remained limited. Commercial banks have in many cases concentrated on the short-term financing of foreign trade transactions, and have often tended to refrain from making loans and investments in the domestic sector of the economy. Moreover, in many countries large sections of the population have remained outside the market economy, and continue to be unfamiliar with banking practices and facilities. For these and other reasons, the

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scope for influencing the cost and availability of credit by means of the traditional central banking techniques, notably open market and discount operations, has been limited.

In recent years, however, significant progress has been made in many of the countries in establishing and expanding specialized agricultural and industrial credit institutions to meet the credit needs of the domestic sector of the economy and to bridge the gap between the less developed parts of the economies and the monetary and banking systems. Simultaneously, efforts are being made in some of the countries to develop a market in government securities. The role of institutional intermediaries between savers and borrowers—social security funds, development corporations, insurance companies, and the like—has been strengthened legislatively as well as by an increased flow of savings. The commercial banks, with the growth of domestic enterprise and production, have come to take a more active interest in local industry and commerce—an interest that in most cases has been strongly encouraged by the authorities. As a result of all these developments, the financial structures of a number of countries have become somewhat more responsive to the influence of the monetary authorities.

The effective application of monetary policy in Latin America has been hampered in the past also by the frequent recourse of many governments to central bank credit. Desirous of speeding up economic development, governments have tended to superimpose extensive investment programs on the ordinary budget. However, the total of the resulting expenditures has frequently exceeded the relatively limited funds that could be obtained from taxes, borrowings from the public, and other noninflationary sources. The governments have therefore tended to rely heavily on central bank credit to cover budgetary deficits, and this in many cases has seriously impaired the ability of the monetary authorities to control the supply of money and credit.

Recently, however, there has been an increased awareness in many Latin American countries of the high economic and social costs of inflation. In particular, it is being realized that under conditions of reasonable monetary stability it is far easier to increase the available resources for economic development and to channel them into the projects most essential for promoting the growth of real incomes than when inflation prevails. It has become evident, for example, that the development of a government securities market depends on the removal of the threat of constant capital depreciation, and also that foreign capital can be far more readily attracted when inflation and its by-products such as exchange restrictions and devaluation are avoided. Increasing efforts are thus being made to restrict the inflationary financing of development projects.

The dependence of most Latin American countries on the export of a few primary commodities for the bulk of their exchange earnings, as well as for a substantial part of their national income, has also tended to limit the scope of monetary policy. Wide swings in the volume and value of such exports have exposed these countries to correspondingly wide variations in their exchange earnings and their international reserves; the resulting variations in the money supply have been difficult for the monetary authorities to control. While some of the countries have succeeded on occasion in restraining the inflationary influences arising from export booms, they have generally found it very difficult to stimulate business activity through monetary measures during export recessions, especially since an expansion of domestic credit has usually led to serious drains on their international reserves. Thus many Latin American countries during the 1930's and early 1940's came to place greater reliance on exchange and trade policies than on credit-control measures, since the former appeared to offer a somewhat better chance of mitigating the domestic impact of abrupt changes in export earnings.

More recently, however, world market conditions have by and large been advantageous for Latin America. During the past few years the demand for such important Latin American mineral and agricultural export products as copper, lead, zinc, iron ore, petroleum, and bananas has remained high, and prices have been relatively favorable because of the high level of business activity and consumer incomes in the United States and the other principal export markets. Although the demand for other leading export products such as coffee and cocoa has continued to fluctuate more widely, their prices in most cases have remained favorable by any earlier standards, exception being made for the commodity boom that followed the Korean outbreak. The complications for monetary policy arising from major externally induced swings in the balance of payments have therefore not been so great as in earlier years, and the monetary authorities have been better able to make their policies effective.

Commercial Bank Reserve Requirements

Although Latin American central bank legislation, as already noted, has undergone extensive changes since 1945, many of the countries even earlier had from time to time revised the statutory powers of their central banks in a continuous search for the credit-control instruments most adaptable to the relatively undeveloped financial structure of their economies. Since such revisions have usually taken the form of adding new powers to the existing ones, most Latin American central banks now have authority to apply instruments of credit control equal or even superior in variety and flexibility to those available in most other regions of the world. Virtually all of these various controls have at one time or another actually been employed in some Latin American country. However, in recent years there has been a distinct trend toward using commercial bank reserve requirements and central bank discount policies as the major instruments of general credit control.[2]

[2] There are three Latin American republics—Brazil, Haiti, and Panama—that have officially controlled credit institutions exercising certain central banking functions, but which operate principally as commercial banks. References made in this article to the Brazilian monetary authorities should be understood as applying mainly to the Superintendency of Money and Credit, an agency that exercises most of the regulatory functions of a central bank in Brazil.

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Most Latin American countries require commercial banks to hold amounts equal to specified percentages of their demand and time deposits as cash reserves with the central bank.[3] At one time this requirement had served principally to protect bank depositors; but now the main emphasis in most of the countries is being placed on the use of cash reserve requirements as a monetary policy instrument designed to influence the availability of bank credit. More particularly, most Latin American central banks now have the authority (sometimes shared with the government or such agencies as superintendencies of banks) to vary reserve requirements within fairly wide limits. In Colombia, for example, the cash reserve requirements against demand deposits may be varied between 10 and 30 per cent, and in Cuba between 12½ and 40 per cent.

The authorities of many countries—including Brazil, Colombia, Ecuador, Mexico, Peru, and some countries in Central America—also have the power to impose supplementary reserve requirements against the *increases* in deposits that take place after a given date. Such supplementary requirements, which in some cases may be set as high as 100 per cent, provide a way for dealing with some of the problems that would arise if cash reserve requirements against total deposits were increased in cases where excess reserves in the banking system are distributed unevenly among the individual commercial banks—a frequent occurrence in many Latin American countries. On the other hand, if the supplementary requirements remain in force for some time, they tend to penalize new and growing commercial banks, especially since they usually have to be fairly high in order to exert any real restraint.

In recent years, variations in cash reserve requirements have been employed with particular frequency in Colombia, Mexico, and Peru and, to some extent, also in Bolivia, Brazil, and Honduras. Between early 1954 and late 1955, for example, the Colombian authorities once raised and once lowered the cash reserve requirements of commercial banks, while changing supplementary reserve requirements a total of five times. In Peru, supplementary requirements were once eased and once tightened during 1955. In many of these instances, considerations relating to the country's balance of payments played an important part in the decision to change the reserve requirements. Thus, the increases in reserve requirements in Colombia during 1954 served mainly to offset the expansionary effects on the money supply and bank reserves of the inflow of foreign exchange resulting from the high earnings from coffee exports in that year. When the export boom later subsided, reserve requirements were adjusted downward, but were tightened again for a number of months in 1955 when large credit-financed imports led to a decline in international reserves. The recent tightening in Peruvian reserve requirements likewise was undertaken when inflationary pressures, originating mainly from domestic credit expansion, threatened to endanger the country's balance-of-payments stability, which had only recently been restored.[4]

The case of Mexico, however, is somewhat different. In that country, the required reserves have for some years consisted not only of cash but also of government securities and specified types of loans. Here, reserve requirements have become, at least in part, a tool of selective credit control, aimed at influencing the direction rather than the quantity of bank credit. Nevertheless, the proportion of the required reserves that must be in cash continues to be altered from time to time; furthermore, reserve-eligible securities have at times been available only at the central bank. The Mexican reserve requirements have thus had quantitative as well as selective effects on bank lending.

Discount Policy

The rise in the importance of discount policy—the second major tool of monetary policy in Latin America—is a relatively recent development. The power to extend credit to commercial banks against various types of eligible paper at rates specified by the monetary authorities had, of course, long been incorporated in the statutes of many of the central banks. This power has been greatly widened in a number of the countries in recent years, especially as regards the classes and maturities of the paper eligible for discount or as collateral against advances. Several of the central banks—for example, those of Guatemala and Honduras—may now accept for discount, or as collateral against advances, any bills of exchange, acceptances, promissory notes, or other documents, all with maturities of up to one year. Such paper may be based on a wide variety of transactions, including agricultural and industrial production, exports and imports, and the storage of commodities. These powers, however, also have often remained unused for long periods, in large part because the commercial banks frequently considered indebtedness to the monetary authorities as undesirable, and have therefore operated with excess reserves so ample as to make recourse to the central bank unnecessary except in extraordinary circumstances. In the virtual absence of discount operations, the central banks have experienced great difficulties in influencing the cost of credit through discount rate variations.

These limitations on the effectiveness of discount policy are gradually being overcome in many countries. In some of the countries, the monetary authorities have been brought into closer contact with the credit markets through the establishment of commercial banking departments within the central banks. Central bank lending to the public remains of considerable importance in a number of countries, notably Bolivia, Ecuador, Nicaragua, and Uruguay. In recent years, however, a more important factor in increasing the effectiveness of discount policy has been the gradual weakening of the commercial

[3] See also "Commercial Bank Reserve Requirements Abroad", *Monthly Review*, October 1955.

[4] For a review of Peru's earlier policies to deal with balance-of-payments difficulties, see "Economic Stabilization in Peru", *Monthly Review*, March 1955.

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bank tradition against rediscounting. This factor seems to have become particularly significant in Brazil and Colombia, but the tendency is also spreading to other countries, including several of the Central American republics. Many of the Latin American central banks are also able to influence general monetary conditions by varying the volume of their credit to officially controlled credit institutions such as agricultural and industrial development banks. The loans of such institutions now constitute a substantial proportion of total bank lending in a number of countries, including Ecuador, Guatemala, Mexico, Paraguay, and Peru. It may be noted, however, that several of the central banks have frequently found it difficult to restrict their loans to these institutions at times when such restraint appeared to be called for in the broader interests of monetary stability.

Most Latin American central banks still vary only infrequently the rates at which they grant discounts and advances, and rely rather on regulating the quantity of central bank credit available to borrowers, either in the aggregate or individually. Nevertheless, discount rate changes, combined with other appropriate measures, seem on occasion to have proved a useful tool. For example, the Brazilian authorities during 1954 raised the principal discount rates to 8 and 10 per cent from a previous single rate of 6 per cent; these increases, together with restrictions on the rediscounts available to the individual banks and the imposition of supplementary cash reserve requirements, apparently were of considerable help in slowing down the pace of credit expansion during late 1954 and the first half of 1955. Many of the Latin American central banks quote a scale of discount rates rather than a single rate, with the preferential rates serving as a means of redirecting bank credit toward the sectors of the economy regarded as contributing most to economic development, but these rates likewise have been changed only infrequently.

Other General Credit Controls

Unlike reserve requirements and discount policy, open market operations are not yet an established instrument of monetary policy in Latin America. Government securities—the preferred medium for such operations—still have only a narrow market among Latin American investors (including the commercial banks), and it is generally realized in Latin America that a broadening of that market must precede the effective use of open market operations. To accomplish such a broadening, several countries—among others the Dominican Republic, Ecuador, Guatemala, and Honduras—have established special securities-stabilization funds, to be administered by the central banks and used for open market operations designed to increase the liquidity of government securities by preventing or moderating sharp price fluctuations. In a number of other countries, including particularly Costa Rica, Cuba, and Mexico, the central bank has often followed the policy of supporting, at or near par, some or even most of the bond issues of the government and the various official entities. In some countries—most notably Mexico—such policies may have helped to widen the ownership of government securities among private and corporate investors, but commitments to support a broad range of securities at high levels have also tended to impede efforts to prevent an overly rapid expansion of the money supply.

Other forms of general credit control also have on occasion been used by the Latin American monetary authorities. In Costa Rica, for example, the central bank has for some years used credit ceilings—i.e., quantitative limitations on the loans and advances of banks both in the aggregate and individually—as its chief instrument of monetary control. In emergencies, loan ceilings have also been employed in Bolivia, Chile, Colombia, and Mexico. Argentina has apparently used a modified version of credit ceilings, the power to impose stringent controls on bank lending being derived from a 1946 statute under which the commercial banks may accept deposits only as agents of the central bank.[5] In Colombia, on the other hand, Treasury balances have at various times been shifted between the central bank and the commercial banks as a means of influencing the general availability of bank credit. Chile, finally, has had recourse to restrictions on the rate of increase in commercial bank loans in its recent anti-inflationary drive; these restrictions have been combined with a tightening of discount policy under which the commercial banks have to pay progressively higher rates on their borrowing at the central bank, depending upon the proportion of their discounts to their capital and reserves. In general, however, such special types of general credit controls have gradually declined in importance in Latin America.

Changes in the multiple exchange rate systems now existing in approximately half of the Latin American countries have also on occasion been used as a device of general monetary control. Thus, the sale of foreign exchange at rates higher than those at which the exchange was purchased yields "profits" for the monetary authorities, which can then be sterilized in special official accounts in order to restrain inflationary pressures. In Brazil, for example, substantial funds have at times been accumulated in such a special account since the present Brazilian exchange rate system was put into effect in 1953. As a rule, however, the use of multiple exchange rates for purposes of monetary restraint or expansion has been secondary to their role as a fiscal and exchange control device.

Selective Credit Controls

Latin American central banks have often found it desirable to supplement general monetary measures with selective credit controls designed to encourage or discourage particular types of bank credit and thus influence the allocation of resources in desired directions. In fact, the monetary authorities of some of the countries have often been concerned more with selective than with general credit controls, especially as long as the finan-

[5] The entire legal and institutional structure of Argentine banking is reportedly under review at present.

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cial and economic structure of their countries offered little leverage for the effective application of general monetary measures. Among the many specific objectives sought through the use of selective credit controls have been the redirection of credit into "productive" activities such as industry and agriculture instead of into speculative or "commercial" activities such as the import trade and the holding of commodity stocks; the counteracting of inflationary tendencies apparently originating in the excessive expansion of credit to certain particular sectors of the economy; and assistance in the developing of government securities markets.

Among the methods used to implement these objectives, the practice of granting central bank credit at preferential rates to certain borrowers or for specified purposes is, as already noted, particularly important in many Latin American countries. Rediscount rate scales, rather than single rates, thus exist in many countries, including Brazil, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, and Peru. Under the current Colombian regulations, for example, agricultural paper can be rediscounted at 3 per cent, compared with the general rate of 4 per cent applicable to other paper. Peru, on the other hand, maintains a general rate of 6 per cent for rediscounts to commercial banks, preferential rates of either 3 or 4 per cent for government-controlled credit institutions engaged in promoting agricultural, industrial, and mining production, and a special rate of only 1 per cent for rediscounts of Treasury bills for commercial banks. In several of these cases, the granting of preferential discount rates is made conditional upon satisfactory proof to the central bank that the borrowing bank will in turn reduce the charges to its clients below its ordinary rates.

Selective reserve requirements, employed principally in Mexico but occasionally in Chile and Uruguay as well, have also been used to redistribute credit between various sectors of the private economy as well as to promote the development of the government securities market. For instance, under the Mexican regulations already mentioned, many commercial banks must invest large percentages of their deposits in designated "productive" loans or in government securities, in addition to holding cash reserves. Certain variants on the principle of requiring commercial banks to hold government securities as part of their reserves have also been used. In Cuba, for example, commercial banks have recently been required to invest a part of their deposits in government securities if they wished to remain eligible to receive the deposits of official and semiofficial agencies.

In seeking to discourage "nonessential" imports, Latin American countries have frequently used various selective credit controls along with direct import restrictions and multiple exchange rates. One type that has frequently been used has been the requirement that importers deposit with the authorities, in advance of their purchase of foreign exchange, a part of the local-currency equivalent of their imports, the proportion varying with the category of goods imported. Such requirements have been often employed in Colombia and Ecuador. In addition to affecting the composition of imports, this measure also has been used to ease or restrict the availability of credit for import financing generally.

Concluding Remarks

It is difficult to generalize about the effectiveness of the numerous credit controls that have been used in Latin America. Wide differences exist in the economic and financial development of the various countries, and these differences naturally bear importantly on the relative efficacy of monetary policy in general as well as of the individual monetary control instruments. Nevertheless, it appears that the central banks—particularly in the larger Latin American countries where the domestically oriented sector of the economy has grown rapidly in recent years and where financial institutions have become more diversified and better integrated—now have considerable scope for influencing the availability and cost of credit through general credit controls. Such measures as variations in commercial bank reserve requirements and in the volume of central bank discounts and advances frequently appear to have yielded appreciable results in terms of their stated objectives. This has, of course, been especially the case where monetary measures have been closely coordinated with appropriate foreign exchange and fiscal policies, since the latter continue to be of great importance in all Latin American countries.

The efficacy of the selective credit controls used in Latin America, on the other hand, seems to have been limited. Agricultural and industrial development, it is true, has apparently been considerably stimulated in some of the countries by the channeling of official credit on preferential terms to these sectors of the economy. However, Latin American experience has also shown that the end-use of bank credit that is encouraged or permitted under selective credit regulations cannot be easily controlled; and furthermore that, while a particular credit to finance a specific outlay may in itself be desirable, the total of such outlays may well exceed the available resources and thus generate inflationary pressures. Hence, the monetary authorities of many of the countries now believe that selective credit controls work best as occasional supplements rather than as alternatives to general credit controls.

In spite of the persistence of economic and institutional limitations on the efficacy of monetary policy, the outlook appears to be for a progressively larger role for the flexible use of the available credit-control instruments in Latin America. Economic development in many of the countries has gained considerable momentum in recent years, and as a result financial markets and institutions are likely to grow further and become more diversified. This may well make possible, and indeed necessary, the alternating application of monetary restraints and stimuli in order to assure balanced development without sacrificing monetary stability. The potentialities of monetary policy in Latin America thus seem certain to be further explored and more fully utilized during the coming years.

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DEPARTMENT STORE TRADE

The dollar volume of sales at Second District department stores in March was 1 per cent higher this year than in March 1955, according to preliminary estimates. But, since Easter is a week earlier this year than in 1955, sales would normally be expected to be substantially above those of last March. After adjustment for the shifting date of Easter and the usual seasonal variations, the District daily-average sales index for March is expected to be 102 per cent of the 1947-49 average, 4 per cent lower than the March 1955 index and 3 per cent below February this year. Dollar volume for the first quarter is 5 per cent higher than for the corresponding period last year, however. The disappointing March sales record reflects to some extent a week of snow and rain throughout the District and a severe blizzard in the New York-Northeastern New Jersey metropolitan area.

Sales by Departments in Fiscal 1955-56

Sales in most of the major departments of Second District department stores showed modest gains during the fiscal year ended January 1956. For the stores which report their sales by departments,[1] total sales for the year increased 2 per cent. Sales in the women's and misses' apparel, homefurnishings, and small wares departmental groupings were up 3 per cent, and a better-than-average increase in sales was also recorded by the miscellaneous merchandise group. Substantially higher sales of sporting goods, cameras, and luggage, which are included in the miscellaneous group, account for the latter gain. The piece goods and household textiles, women's and misses' accessories, and men's and boys' wear departments had increases in sales from previous-year levels equal to or less than the average. Of the major departments, only the basement store and nonmerchandise groups were unable to exceed the year-earlier totals.

The diverse trends which had appeared within the women's and misses' accessories and apparel groups in earlier years became more apparent during the last fiscal year, although the proportion of total sales by the two groups combined remained unchanged. Sales of women's and misses' coats and suits were 3 per cent lower than a year earlier, and millinery sales were off 5 per cent. Sales of suits suffered the largest decline in dollar volume (12 per cent) of any individual department in the main store except oriental rugs. Coat sales were 2 per cent lower. Sportswear, "better" dresses, and furs, however, recorded substantial increases (7, 8, and 7 per cent, respectively). The increase in fur sales marked the second successive year of substantial increase in District department stores; in previous years they had showed a consistently declining sales trend. Inexpensive dresses, which were stronger than better dresses in the year ended January 1955, showed a better-than-average gain but not so great as their more expensive counterparts.

Crosscurrents were also evident in the homefurnishing departments. Sales of furniture and bedding, which had increased more than the average during the previous year, and decreased less than most homefurnishings departments since 1951, recorded a slight decline. On the other hand, major household appliances made one of the most striking gains in the main store—17 per cent. Since this increase was substantially above that for appliance sales generally, it indicates that department stores which still offer these goods to their customers may be regaining some of the ground lost in the postwar years in the appliance field. Domestic floor coverings, and radios, records, and television sales were also substantially higher than a year ago, 7 and 14 per cent, respectively. These departments had generally been weak since 1950, although a slight increase occurred in the previous year in radios, records, and television.

[1] Those stores currently reporting sales by departments to this Bank have sales which account for about two thirds of the estimated aggregate sales of Second District department stores.

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

Area	Net sales			Stocks on hand Feb. 29, 1956
	Feb. 1956	Jan. through Feb. 1956	Feb. 1955 through Jan. 1956	
Department stores, Second District	+10	+ 8	+ 4	+10
New York-Northeastern New Jersey Metropolitan Area	+10	+ 9	+ 4	+ 9
New York City	+ 6	+ 5	0	+10*
Nassau, Suffolk, Westchester, and Rockland Counties	+36	+34	+27	
Northern New Jersey	+13	+11	+ 5	+ 5
Newark	+12	+ 9	0	—
Fairfield County	+19	+14	+10	+10
Bridgeport	+14	+12	+ 8	—
Lower Hudson River Valley	+ 6	+ 3	+ 7	+25
Poughkeepsie	+ 4	+ 1	+ 6	+25
Upper Hudson River Valley	+10	+ 8	+ 4	+23
Albany-Schenectady-Troy Metropolitan Area	+10	+ 8	+ 4	+20
Albany	+14	+12	+ 7	n.a.
Schenectady	+ 5	+ 4	− 1	+ 9
Central New York State	+ 6	+ 6	+ 5	+ 6
Utica-Rome Metropolitan Area	+ 8	+ 6	+ 3	+15
Utica	+ 4	+ 4	+ 4	+14
Syracuse Metropolitan Area	+ 5	+ 6	+ 5	+ 3
Northern New York State	n.a.	n.a.	n.a.	n.a.
Southern New York State	+ 6	+ 5	+ 2	+13
Binghamton Metropolitan Area	+ 6	+ 5	+ 4	+14
Western New York State	+ 5	+ 5	+ 3	+10
Buffalo Metropolitan Area	+ 5	+ 4	+ 3	+10
Buffalo	+ 4	+ 3	+ 2	+10
Niagara Falls	+ 6	+ 2	+ 2	—
Rochester Metropolitan Area	+ 6	+ 8	+ 3	+ 9
Apparel stores (chiefly New York City)	+ 9	+ 4	+ 2	+12

* Separate figures for New York City and the other counties are not available.
n.a. Not available.

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

Item	1956		1955	
	Feb.	Jan.	Dec.	Feb.
Sales (average daily), unadjusted	85	90	194	82
Sales (average daily), seasonally adjusted	105	114	110	101
Stocks, unadjusted	116	108	110	107
Stocks, seasonally adjusted	124	122	121	114

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SELECTED ECONOMIC INDICATORS

United States and Second Federal Reserve District

Item	Unit	1956		1955		Percentage change	
		February	January	December	February	Latest month from previous month	Latest month from year earlier
UNITED STATES							
Production and trade							
Industrial production*	1947-49 = 100	143p	143	144	133	#	+ 8
Electric power output*	1947-49 = 100	213	211	207	186	+ 1	+15
Ton-miles of railway freight*	1947-49 = 100	—	110p	105	97	+ 5	+13
Manufacturers' sales*	billions of $	27.2p	27.0	27.3	24.6	+ 1	+11
Manufacturers' inventories*	billions of $	46.8p	46.3	45.9	43.3	+ 1	+ 8
Manufacturers' new orders, total*	billions of $	27.8p	28.1	29.3	24.8	− 1	+12
Manufacturers' new orders, durable goods*	billions of $	14.3p	14.7	15.6	12.2	− 3	+17
Retail sales*	billions of $	—	15.7p	15.8	14.8	− 1	+ 5
Residential construction contracts*	1947-49 = 100	337p	290	273	295r	+16	+14
Nonresidential construction contracts*	1947-49 = 100	289p	306	319	238	− 6	+21
Prices, wages, and employment							
Basic commodity prices†	1947-49 = 100	88.9	89.4	89.7	91.4	− 1	− 3
Wholesale prices†	1947-49 = 100	112.3p	111.9	111.3	110.4	#	+ 2
Consumer prices†	1947-49 = 100	114.6	114.6	114.7	114.3	#	#
Personal income (annual rate)*	billions of $	—	312.5p	314.8	293.2	− 1	+ 7
Composite index of wages and salaries*	1947-49 = 100	—	145p	145	139	#	+ 4
Nonagricultural employment*	thousands	50,179p	50,293p	50,228	48,470	#	+ 4
Manufacturing employment*	thousands	16,807p	16,903p	16,967	16,091	− 1	+ 4
Average hours worked per week, manufacturing†	hours	40.6p	40.6	41.3	40.4	#	#
Unemployment	thousands	2,914	2,885	2,427	3,383	+ 1	−14
Banking and finance							
Total investments of all commercial banks	millions of $	75,730p	77,350p	78,320p	83,640	− 2	− 9
Total loans of all commercial banks	millions of $	82,570p	82,000p	82,760p	71,180	+ 1	+16
Total demand deposits adjusted	millions of $	105,590p	108,850p	109,690p	104,500	− 3	+ 1
Currency outside the Treasury and Federal Reserve Banks*	millions of $	30,396p	30,559	30,592	29,964	− 1	+ 1
Bank debits (337 centers)*	millions of $	76,830	74,718	72,755	67,467r	+ 3	+14
Velocity of demand deposits (337 centers)*	1947-49 = 100	130.6p	134.4	128.1	123.1	− 3	+ 6
Consumer instalment credit outstanding†	millions of $	27,784	27,769r	27,895	22,508	#	+23
United States Government finance (other than borrowing)							
Cash income	millions of $	7,089	4,729	5,353	6,306	+50	+12
Cash outgo	millions of $	5,600	5,323	6,264	5,481	+ 5	+ 2
National defense expenditures	millions of $	3,075	3,394	3,312	3,128	− 9	− 2
SECOND FEDERAL RESERVE DISTRICT							
Electric power output (New York and New Jersey)*	1947-49 = 100	156	159	153	143	− 2	+ 9
Residential construction contracts*	1947-49 = 100	—	219p	195	242	+13	#
Nonresidential construction contracts*	1947-49 = 100	—	358p	302	203	+18	+55
Consumer prices (New York City)†	1947-49 = 100	112.1	112.1	112.0	112.5	#	#
Nonagricultural employment*	thousands	—	7,674.2p	7,691.3	7,495.8r	#	+ 2
Manufacturing employment*	thousands	—	2,671.6p	2,678.6	2,602.3r	#	+ 3
Bank debits (New York City)*	millions of $	63,792	67,646	68,667	63,434	− 6	+ 1
Bank debits (Second District excluding New York City)*	millions of $	5,045	4,989	4,773	4,489	+ 1	+12
Velocity of demand deposits (New York City)*	1947-49 = 100	161.1	173.7r	173.3	164.1	− 7	− 2

Note: Latest data available as of noon, March 30, 1956.

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.

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