// MONTHLY REVIEW
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## MONEY MARKET IN OCTOBER

Member bank reserve positions remained under relatively steady pressure during most of October, although a sharp rise in float just after the middle of the month eased the pressure temporarily at that time. The money market continued tight throughout, however, with Federal funds firmly bid at the 3½ per cent ceiling on every day. Short-term interest rates advanced toward the middle of the month, and longer regular Treasury bills traded at slightly below 3⅝ per cent over the latter half of the month as compared with about 3½ per cent early in the period. Most longer term yields showed mixed changes; the Treasury 3¼'s of 1978-83 closed the month to yield 3.70 per cent, 5 basis-points above the yield at the end of September, and the 3's of 1995 closed at 3.60 per cent, up 4 basis-points. However, yields on long-term corporate bonds remained fairly stable and those on municipals declined. These and other developments are described more fully below.

### Member Bank Reserve Positions

Except for the temporary easing in the week ended October 23, member bank reserve positions remained under fairly steady pressure during the five statement weeks ended in October. Net borrowed reserves averaged 380 million dollars for the full five weeks, about 50 million lower than in September. In the statement week ended October 23, the midmonth rise in float temporarily supplied a large volume of funds to the banking system, as the accompanying table shows. Most of these funds were withdrawn in the final week, but net borrowed reserves did not return to the high level prevailing earlier in October. Over the month as a whole, member bank borrowings from the Reserve Banks amounted to 845 million, about 130 million lower than in September, while average excess reserves declined to 465 million from 540 million.

Reserve positions tightened early in the period when required reserves rose sharply, partly as the result of bank payments through Tax and Loan Accounts for their purchases of the new Treasury securities sold in mid-September. Payment for the 4 per cent certificates and notes was due on September 26, and at least one half of the payment for the 4 per cent bonds sold at the same time was due on October 1, with the remainder deferred if desired until not later than October 21. (Most subscribers elected to make full payment for the bonds on October 1.) Although average float declined by some 300 million dollars during the first of the five statement weeks, when required reserves were rising, the impact of these pressures on reserves was offset by funds supplied through a reduction in Treasury balances with the Reserve Banks to normal working levels, by System purchases of Government securities (including outright purchases and those made under repurchase agreements), and by other factors. Average member bank borrowing from the Reserve Banks actually declined by 165 million dollars during the week ended October 2, almost fully accounting for the drop in excess reserves.

Day-to-day fluctuations in reserve positions remained in a relatively narrow band until the middle of the month, when float rose substantially and most other operating factors also added to the reserve base. System securities operations absorbed some of these reserves, but member banks used the largest part of the funds briefly available to them at that time to reduce their indebtedness to the Reserve Banks. During the week ended October 23, average member bank borrowing from the Reserve Banks declined by 387 million dollars to 598 million, the lowest level since the last week in July.

In the final statement week of the period, net borrowed reserves moved back to about 350 million dollars as float averaged 466 million dollars lower than in the preceding

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week. Part of this loss of funds was offset by a return flow of currency from circulation, but member banks also found it necessary to step up their average borrowing from the Reserve Banks to 703 million.

System holdings of Government securities were increased by 83 million between September 25 and October 30, as outright holdings of Treasury bills rose by 22 million dollars and there was a net increase of 61 million dollars in short-term Government securities held under repurchase agreements. Repurchase agreements were written in largest volume early in October to alleviate the strains on the money market stemming from the reserve pressures during the first two statement weeks of the month. The outstanding balance rose from zero on September 25 to 148 million on October 2 and remained at that level one week later. By October 16, however, the balance had fallen to 53 million, all of which was retired before the next statement date, October 23. In the final week of the month, new acquisitions of securities under repurchase agreements were arranged to relieve renewed pressures on bank reserves; the outstanding balance totaled 61 million dollars on October 30.

## Government Securities Market

Prices of Treasury notes and bonds generally moved moderately higher early in the month, turned around and fell back rather rapidly between October 8 and October 17, and then fluctuated irregularly upward over most of the remainder of the period. Outright investment demand was generally light, with trading confined for the most part to tax-switching operations as dealers and investors attempted to assess the implications of a wide variety of uncertainties confronting the market. Prices moved upward early in the month, as the firm tone in the corporate and municipal bond markets reinforced a developing opinion that interest rates were not likely to rise further in the near future. On the other hand, views regarding the outlook for interest rates were tempered by the realization that the volume of new bond flotations scheduled for the forthcoming months was still unusually large.

The announcement late on Friday, October 4, of the successful launching of an earth satellite by the Soviet Union gave rise to considerable speculation with respect to the impact of this development on Government defense spending, the debt ceiling, and the cash needs of the Treasury in forthcoming months. Announcements by the United States Defense Department of curtailment of progress payments to defense contractors clouded the picture further, as did conflicting rumors in the market regarding the future course of Federal Reserve policy. In addition, the announcement on October 15 that the Federal National Mortgage Association (FNMA) would issue 750 million dollars of short-term notes injected further uncertainty into the outlook for interest rates. Concern over such influences was reflected in a sharp drop in the prices of Treasury bonds and notes between October 8 and October 17.

By October 18, however, prices steadied, and over the balance of the month they tended to move irregularly higher, in many cases regaining all of the losses of the midmonth period and recording small gains for the month as a whole. Market atmosphere seemed to be primarily influenced by uneasiness regarding near-term business prospects and by sharp declines in stock market prices.

Over the month as a whole, the prices of most Treasury bonds and notes maturing through 1962 showed mixed changes, ranging from losses of about ⅛ of a point to gains of about ⅜ of a point. Issues due after 1962 and through 1972 generally rose by ⅛ to ⅜ of a point. The 3¼'s of 1978-83 closed at $92^{20}/_{32}$ (bid), down $^{26}/_{32}$ of a point over the month, and the 3's of 1995 closed at $87^{22}/_{32}$, down ¾ of a point. The new 4 per cent Treasury notes of 1962, issued last month, fluctuated close to par over most of the month and closed at $100^{6}/_{32}$ (bid), a rise of ¼ of a point over the period. The new 4 per cent bonds of 1969 fell as low as ¼ of a point below par in mid-October, but then recovered, and closed the month at $100^{1}/_{32}$, a gain of $^{2}/_{32}$ of a point over the month.

As mentioned above, the Treasury announced on October 15 that the FNMA would offer 750 million dollars of short-term notes for cash subscription on October 21, the proceeds to be used to retire borrowings from the

**Table I**

**Changes in Factors Tending to Increase or Decrease Member Bank Reserves, October 1957**

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

| Factor | Daily averages—week ended | | | | | Net changes |
|---|---|---|---|---|---|---|
| | Oct. 2 | Oct. 9 | Oct. 16 | Oct. 23 | Oct. 30 | |
| *Operating transactions* | | | | | | |
| Treasury operations* | + 262 | − 2 | − 9 | + 40 | − 58 | + 233 |
| Federal Reserve float | − 318 | − 9 | + 80 | + 446 | − 466 | − 267 |
| Currency in circulation | + 14 | − 91 | − 62 | + 62 | + 121 | + 44 |
| Gold and foreign account | + 35 | − 4 | + 52 | + 23 | + 5 | + 111 |
| Other deposits, etc. | + 79 | − 7 | + 10 | − 12 | + 66 | + 136 |
| Total | + 71 | − 113 | + 71 | + 559 | − 331 | + 257 |
| *Direct Federal Reserve credit transactions* | | | | | | |
| Government securities: | | | | | | |
| Direct market purchases or sales | + 121 | + 18 | − 31 | − 59 | − 43 | + 6 |
| Held under repurchase agreements | + 47 | + 181 | − 143 | − 45 | − 29 | + 11 |
| Loans, discounts, and advances: | | | | | | |
| Member bank borrowings | − 165 | + 68 | − 18 | − 387 | + 105 | − 397 |
| Other | — | — | — | — | — | — |
| Bankers' acceptances: | | | | | | |
| Bought outright | − 2 | — | — | − 1 | — | − 3 |
| Under repurchase agreements | — | — | — | + 2 | − 2 | — |
| Total | — | + 268 | − 192 | − 490 | + 31 | − 383 |
| *Total reserves* | + 71 | + 155 | − 121 | + 69 | − 300 | − 126 |
| *Effect of change in required reserves*† | − 259 | + 5 | + 47 | + 4 | + 96 | − 107 |
| *Excess reserves*† | − 188 | + 160 | − 74 | + 73 | − 204 | − 233 |
| Daily average level of member bank: | | | | | | |
| Borrowings from Reserve Banks | 935 | 1,003 | 985 | 598 | 703 | 845‡ |
| Excess reserves† | 393 | 553 | 479 | 552 | 348 | 465‡ |

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

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for five weeks ended October 30.

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Treasury. The 4⅞ per cent Series ML notes were dated October 29 and are to mature on June 26, 1958. The Treasury handled the offering for the FNMA, and, although payment by Treasury Tax and Loan Account credit was not permitted, arrangements were made between the FNMA and the Treasury whereby the Treasury deposited with qualified banks, on request, amounts equal to the notes allotted to such banks for themselves and their customers. After some initial hesitancy immediately after the announcement of the 4⅞ per cent coupon (rather than 5 per cent as expected by some observers), the issue was fairly well received by the market. However, commercial banks were restrained in their subscriptions because of uncertainty over their ability to liquidate allotments quickly on a "when-issued" basis in the secondary market. Total subscriptions aggregated 1.6 billion dollars; subscriptions of $100,000 or less were allotted in full and others received 44 per cent of their bids, with a minimum of $100,000.

The market for Treasury bills was generally in balance early in the period but weakened at midmonth, and the average issuing rate in the regular weekly auction climbed to a post-1933 high of 3.660 per cent for the bills dated October 17. This represented an increase of 14 basis-points from the average issuing rate of 3.525 per cent established in the first auction of the month, held on October 7, with the advance primarily attributable to a slackening of demand and a reluctance of dealers to increase their inventories at prevailing high borrowing costs. Investment demand picked up gradually after midmonth, and the average issuing rate declined to 3.619 per cent on October 21. In the final auction, held on October 28, the rate held steady at 3.622 per cent, and three-month bills were bid at 3.60 per cent by October 31.

## Other Securities Markets

Both the corporate and municipal bond markets remained relatively firm during October, with trading particularly active in the tax-exempt area. For the most part, new municipal issues were aggressively bid for by underwriters and attracted a favorable investor response; the corporate market was not quite so robust, and for a while new issues moved rather slowly, but it was still marked by generally stable yields. The impression seemed to be circulating, as in the market for Governments, that long-term yields had reached their peak for the present and were unlikely to move higher in the coming months. However, a continued heavy calendar of future offerings created a considerable amount of uncertainty regarding the prospects for significantly lower yields.

Prices of outstanding issues tended upward in both markets over most of the first half of the month but sagged slightly during the latter part of the period. Moody's index of yields on seasoned long-term Aaa-rated municipal bonds closed the month at 3.30 per cent, a decline of 11 basis-points since the end of September, but the long-term Aaa-rated corporate bond index was unchanged at 4.12 per cent. (The recent highs in these indexes have been 3.45 per cent for the municipals at the end of August, and 4.15 per cent for the corporates near the end of September.)

New municipal flotations were generally well received despite a heavy volume of new public offerings totaling an estimated 605 million dollars, 250 million more than in the previous month and 80 million more than in October of 1956. Among the new municipal issues marketed early in the month was a 31 million dollar Aa-rated State bond flotation which carried a 3.32 per cent net interest cost to the borrower. These bonds had first been offered for competitive bidding early in September but the best bid at that time, entailing an interest cost of 3.68 per cent, was rejected by the borrower because of a technicality. The unplanned delay in the sale of the bonds thus saved the borrower a substantial sum in interest charges and furnished a measure of the change in market atmosphere. As a further example, in the middle of the month a 64 million dollar Aa-rated State bond issue was well received at a net interest cost to the borrower of 3.49 per cent, 15 basis-points below the interest cost to the same borrower on a smaller flotation in August.

Public offerings of corporate bonds for new capital purposes are estimated to have totaled 535 million dollars during the month, 55 million below the previous month and 225 million more than in October of last year. The month's only Aaa-rated corporate flotation, a 100 million dollar issue of 35-year utility debentures, was marketed early in the period at a price to yield investors 4.70 per cent—almost the same as the 4.71 per cent on the previous similarly rated issue, which had been marketed late in September. The October issue, which is callable at 110 for the first five years and at declining prices thereafter, moved slowly at first, but sales picked up as the month progressed. Toward the end of the month a 250 million dollar flotation of Aa-rated 26-year telephone utility debentures, noncallable for the first five years, moved slowly when reoffered at 4.90 per cent. This was the largest offering since a flotation of similar size by the same borrower this past March, which had moved well when reoffered to yield 4.30 per cent.

On October 8 most dealers in open market commercial paper raised their rates by ⅛ of 1 per cent on all maturities, and the others followed suit on October 9. This rise, the first since August 7, brought the dealer offered rate on prime four-to-six months' paper to 4⅛ per cent; in the two months since the previous rate increase most other short-term rates had also been realigned upward.

## Member Bank Credit

Total loans and investments of the weekly reporting banks decreased by 513 million dollars between September

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18 and October 23, as a 994 million dollar fall in total loans more than offset a 481 million dollar expansion in investment holdings.

The loan contraction was attributable to an 800 million dollar fall in business loans, in large part the result of net repayments by sales finance companies amounting to almost 500 million dollars over the five-week period. Metals and metal products firms also reduced their bank borrowings substantially, while seasonal increases were posted by food, liquor, and tobacco firms and by commodity dealers. In each of these latter cases, however, the rise was less than that recorded during the corresponding weeks last year. Retail and wholesale trade concerns also increased their bank borrowings, in this case by about the same amount as in the corresponding weeks last year.

The rise in investment holdings stemmed primarily from bank acquisition of the 4 per cent certificates, notes, and bonds sold by the Treasury in September and acquired by the banks during the week ended October 2. This large expansion in holdings was in part offset by securities sales both before and after that week.

Thus far this year, business loans have risen by 515 million dollars at the weekly reporting banks, but total loans adjusted have fallen by 174 million. In the corresponding period last year, business loans rose by 3.1 billion dollars, total loans by 3.4 billion. The bulk of the 3.6 billion dollar shortfall in the growth of total loans this year as compared with last is thus attributable to the 2.6 billion dollar relative decline in business loans. The reduced rate of growth in business loans this year may be at least partially attributable to high rates of corporate securities flotations and smaller growth of business inventories.

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

| Item | Statement week ended | | | | | Change from Dec. 26, 1956 to Oct. 23, 1957 |
|---|---|---|---|---|---|---|
| | Sept. 25 | Oct. 2 | Oct. 9 | Oct. 16 | Oct. 23 | |
| *Assets* | | | | | | |
| Loans and investments: | | | | | | |
| Loans: | | | | | | |
| Commercial and industrial loans | − 196 | − 82 | − 188 | − 34 | − 300 | + 515 |
| Agricultural loans | + 1 | + 5 | − 6 | — | + 4 | − 21 |
| Securities loans | − 58 | + 277 | − 100 | − 1 | − 338 | − 716 |
| Real estate loans | + 7 | + 2 | + 2 | + 30 | + 10 | − 83 |
| All other loans (largely consumer) | − 19 | + 33 | − 44 | + 28 | − 26 | + 318 |
| Total loans adjusted* | − 265 | + 231 | − 335 | + 25 | − 650 | − 174 |
| Investments: | | | | | | |
| U. S. Government securities: | | | | | | |
| Treasury bills | − 152 | − 109 | − 136 | + 59 | + 8 | − 808 |
| Other | − 58 | +1,226 | − 194 | − 37 | − 84 | − 576 |
| Total | − 210 | +1,117 | − 330 | + 22 | − 76 | − 1,384 |
| Other securities | − 19 | − 8 | + 34 | − 22 | − 27 | + 172 |
| Total investments | − 229 | +1,109 | − 296 | — | − 103 | − 1,212 |
| Total loans and investments adjusted* | − 494 | +1,340 | − 631 | + 25 | − 753 | − 1,386 |
| Loans to banks | + 9 | + 2 | − 2 | − 139 | + 95 | − 137 |
| Loans adjusted* and "other" securities | − 284 | + 223 | − 301 | + 3 | − 677 | − 2 |
| *Liabilities* | | | | | | |
| Demand deposits adjusted | − 306 | − 773 | + 329 | + 430 | + 609 | − 2,831 |
| Time deposits except Government | + 75 | + 62 | + 56 | + 19 | − 3 | + 1,886 |
| U.S. Government deposits | + 130 | +1,833 | −1,254 | − 670 | − 425 | − 719 |
| Interbank demand deposits: | | | | | | |
| Domestic | − 621 | + 385 | + 106 | + 540 | −1,029 | − 972 |
| Foreign | − 43 | + 81 | + 20 | + 29 | − 20 | + 38 |

* 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 totals shown.

Total investments have fallen by 1.2 billion, while in the first forty-three weeks of 1956 they contracted by 4.5 billion. Total loans and investments thus far in 1957 are therefore down by 1.4 billion; in the similar period last year they fell by 1.1 billion.

# INTERNATIONAL MONETARY DEVELOPMENTS

## Monetary Trends and Policies

**United Kingdom.** Attention remained focused on the tightening of monetary policy that had taken place in September. Amid early evidence of its effectiveness in strengthening the pound, the authorities made further statements concerning the background, nature, and objectives of the restrictive measures they had taken. Addressing the annual bankers' dinner at the Mansion House, the Chancellor of the Exchequer declared that the government's policy, although harsh, was called for because "the choice is not really between the strength of the pound sterling or full employment, for in the long run the first is a prerequisite to the second". While stressing that the wage-price spiral could not be halted overnight, the Chancellor reaffirmed his confidence in the measures taken and made clear once again the government's determination to push them through to success.

Speaking on the same occasion, the Governor of the Bank of England explained that the exceptional 2 per cent increase in the discount rate had been decided upon because a more positive use of the bank rate was needed to protect the pound and because the parallel action taken by the government in other fields suggested that the increase would have "decisive effects on the economy". However, the Governor stated that the authorities must also feel free to move the rate downward when necessary, warning that "unless we can all accustom ourselves to adjustments of Bank Rate to the requirements of the moment, without heralding minor reductions from crisis levels as a signal for new excesses of spending, Bank Rate will gradually lose its utility". The Governor went on to emphasize that it was necessary for monetary restraint to be supported by complementary fiscal policy and debt management measures if the money supply was to be held stable, stating that "sterling will need to be buttressed under present circumstances, not only by an increasing surplus on balance-of-payments account, but also an over-all surplus on budget account".

In the first half of the British financial year, which began April 1, the deficit in the ordinary budget was nearly 100 million pounds less than a year ago, but this was largely offset by a substantial increase in "below-the-

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line" (mainly capital) expenditures, so that the over-all deficit was only slightly lower than in 1956-57. These trends in the budget point up the importance to the government's fiscal policy of the decision announced in September to hold investment in the public sector in 1958 and 1959 to this year's level. In the sphere of debt management, the Treasury announced on October 11 that no conversion offer would be made to replace the 503 million pounds of 2¼ per cent Funding Stock maturing in mid-November, since over four fifths of the issue had already been brought into official hands. By mid-November the Treasury will have made a net repayment of about 800 million pounds of maturing debt, mainly, as has been officially stated, through the sale to the public of longer dated securities from official portfolios against this year's maturities. While it has thus been possible to avoid adding to the heavy maturities over the next few years, the Treasury's debt management operations have involved some increase in the floating debt. However, the Treasury announcement made it clear that the authorities would continue to follow a policy of "reducing the floating debt at all suitable opportunities by the most appropriate methods".

The recent upward trend of British interest rates ceased in October. Prices of gilt-edged securities, which had been declining sharply and reached a 36-year low in September following the discount rate increase, recovered somewhat last month; the yield of 2½ per cent Consols declined from the September high of 5.56 per cent to 5.43 per cent on October 31. The average Treasury bill tender rate, which had risen for six successive weeks prior to the discount rate increase and had reached 6.60 per cent at the following tender, remained virtually unchanged at this level throughout October. The fall in bank loans that began after the middle of the year continued during the eight weeks to mid-October when the London clearing banks' advances declined a further 42 million pounds. Although this was a smaller reduction than had taken place a year ago and advances on October 16 were still well above the 1956 level, they were about 20 million pounds beneath the ceiling that the authorities had requested the banks to observe in September. The banks' net deposits rose substantially in the two months to mid-October as the decline in advances was more than offset by an 87 million pound increase in the banks' Treasury bill holdings and a further rise in their investments; the banks' liquidity ratio rose 1 percentage point to 36.2 per cent.

**Canada.** The steady upward trend of long-term interest rates was interrupted last month, as the yields of long-term government bonds, which had been rising for six months, receded from the record September levels; yields on medium-term issues declined more sharply, with some issues falling by as much as 0.45 percentage point. In the short end of the bond market, where in mid-September the government had floated a new 700 million dollar issue of one and two-year bonds priced to yield 4.81 and 4.97 per cent, interest rates declined further in October, but the fall was less sharp than in the preceding month. The average Treasury bill tender rate, after having declined for five successive weeks to more than ¼ per cent beneath the August peak, rose slightly during the first three weeks in October but fell back somewhat at the fourth tender and stood at 3.83 per cent on October 25. Thus, while the rate on three months' bills stood at about 3⅞ per cent toward the end of October, the longest dated bonds had declined to nearly 4⅛ per cent and medium-term bonds to about 4⅜ per cent.

Bank lending declined only slightly last month from the record September level, after correcting for the change made at the beginning of October in the statistical basis on which bank loans are reported. The banks' Treasury bill holdings fell by more than 100 million dollars in October, more than offsetting the exceptional September rise of nearly 15 per cent in their bill portfolios. The banks have continued to maintain their cash and liquid assets ratio well above the required minima, and there has been no borrowing at the Bank of Canada for more than ten weeks.

**Philippines.** The Philippine central bank has adopted new measures to restrict credit and curb imports in view of the continuing decline in Philippine foreign exchange reserves. Announcement was made early in September of an increase in the rediscount rate to 4½ per cent from 2. At the same time, a cash margin requirement of 100 per cent was imposed on letters of credit for imports of nonessential consumer goods. The central bank's gold and dollar holdings declined by 24 per cent, or 38 million dollars, during the first eight months of this year because of the rapid growth in the trade deficit as imports rose sharply while exports fell. The central bank had previously increased its discount rate to 2 per cent from 1½ at the end of March, after having suspended rediscounting completely at the end of January.

## Exchange Rates

American-account sterling was in good demand during most of the first half of October. With the exception of October 10 and 11 when the market evidenced some easiness as a result of demand for dollars in London, the quotation steadily appreciated on commercial demand, short covering, and offerings of dollars in London and by midmonth reached \$2.80½, the highest level since June 1956. On October 17, however, as tension in the Middle East increased, the rate fell rather sharply and, at the opening on October 18, was \$2.79$^{11}/_{16}$ after having been as low as \$2.79$^{5}/_{16}$ in London before the New York market opened. Subsequently, on October 21, following a recovery in London on October 19 (Saturday),

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the New York market quoted sterling as high as $2.80 11/32, as a better feeling concerning the Middle East situation developed and commercial interest in sterling was renewed. Thereafter the quotation generally held above $2.80 except for a temporary weakening to $2.79 29/32 on October 24. At the month end American-account sterling was quoted at $2.79⅝. Discounts on three and six months' sterling were narrowed by short covering, in a rather erratic forward market, from 3 5/16 and 5⅛ cents on October 3 and 4, respectively, to 2 and 3⅞ on October 9. Subsequently the discounts widened, and on October 31 stood at 2¼ and 3 27/32 cents.

Buying by sugar interests, and to some extent by central banks, firmed the transferable-sterling quotation from $2.7735 on October 1 to $2.7815 on October 9. After easing somewhat, the rate again turned upward as European interests sought to cover short positions and by mid-month reached $2.7845, the highest quotation since May 1956. On October 18, as Middle East tension rose, transferable sterling weakened to $2.7780 but recovered to $2.7830 by the month end. The securities-sterling market was relatively quiet during the month; the quotations, after fluctuating between $2.71½ and $2.73¼, moved to $2.74½ on October 31.

During the first week of October, commercial demand for United States dollars in Canada and European sales of Canadian dollars weakened the Canadian dollar quotation approximately ⅝ cent to the $1.03 level for the first time since early November 1956. Thereafter, London buying of Canadian dollars reappeared in the market which, together with buying on grain account and short covering, moved the rate upward. Additional strength came from the demand for Canadian dollars associated with the auction of oil leases and the commercial offerings of United States dollars in Canada. During the closing days of the month the Canadian dollar reached $1.04⅛.

The French franc continues to be quoted at about $0.0023 27/32 (approximately 420 francs = U.S. $1) in the New York market. On October 28 the French foreign exchange arrangements introduced on August 10 were revised to provide that the 20 per cent surtax on foreign exchange purchases and the 20 per cent premium on foreign exchange sales be made applicable to those transactions not hitherto subject to them.

# THE NEW YORK FOREIGN EXCHANGE MARKET

The need for a foreign exchange market in the United States arises from the simple fact that some American firms and individuals receive foreign exchange in payment for goods, services, and assets sold abroad, while others make payments to foreigners in foreign money rather than in dollars. Converting foreign exchange into dollars, or dollars into foreign exchange, is essentially a banking function. Most transactions in foreign exchange throughout the United States are consequently handled by commercial banks, and most commercial banks are equipped to service customer requirements in foreign exchange, either directly or through their large correspondents. But like most other nation-wide financial markets, the market in foreign exchange needs one center, where the net balance of supply or demand can ultimately be reflected and where, by the action of what appears to be a centripetal force in the natural law of financial markets, the bulk of the large transactions will actually occur. In foreign exchange, as in all money market instruments, in Government securities of all maturities, in listed equity securities, and in over-the-counter trading of debt or equity instruments, that center is located in New York City.

The foreign exchange market, like these other principal financial markets, is continually changing. It has not grown in volume or diversity of activity, however, in proportion to the growing importance of the dollar as a world currency, particularly as an international reserve currency. This is at least partly because the very importance of the dollar throughout the world has resulted in a much greater expansion of activity abroad, in other foreign exchange centers, where the dollar is sought as one of the world's "hardest" currencies. Nonetheless, the world position of the New York foreign exchange market is a central and critical one. In a broad sense, this market is a mirror reflecting the complex of economic, political, and psychological forces that lie behind the United States balance of payments with the rest of the world, as well as the interrelations among foreign countries that hold and use dollars in making international settlements.

This article will not be primarily concerned, however, with the underlying forces that are constantly being reflected in this market. It will instead attempt to describe the market itself, as it is now functioning. Attention here centers on the organization of the market and the principal instruments in which it deals. A second article for publication in this *Review* will carry the description further into the mechanics and techniques of trading and the day-by-day determination of foreign exchange rates in the New York market.

## The Basis of the Foreign Exchange Market

If all United States trade and payments abroad were carried out in terms of dollars, there would be no need for a foreign exchange market in New York since there would be neither an American demand for foreign exchange nor any supplies of foreign exchange in American hands. There would, of course, be a lively supply of and demand for dollars in foreign exchange markets abroad. This would be reflected on the books of New York banks by the many transfers of dollars among foreign accounts. Dollars earned by foreign exporters, for example, would flow to the accounts of their banks, and dollars paid by foreign importers of dollar products would flow out of the

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# A Testing Period for Monetary Policy

*Remarks of Alfred Hayes, President, Federal Reserve Bank of New York at a Luncheon of the Bond Club of New York, October 16, 1957*

The Bond Club of New York is an audience which I feel especially privileged to address. I can think of few groups who are as well qualified as you to take an understanding interest in the activities and policies of the Federal Reserve System. For while our operations necessarily affect the country's whole economy, their impact is especially prompt and direct in the New York financial community. For our own part, we rely heavily on the efficiency of this community to carry out our open market operations, and we depend to a great extent on our contacts with this community for an appraisal of money and capital market conditions, which is of course a crucial part of the considerations affecting the System's policy decisions. It seems to me fitting that I should express to you on this occasion the System's gratitude for your invaluable cooperation in these activities, as well as for the strong moral support you have given us in our efforts to pursue effective monetary policies.

I suppose that the subject you would most like me to talk about is how we in the Federal Reserve Bank of New York appraise current conditions, and how our policies are influenced by this appraisal. I cannot, of course, go all the way in responding, nor can I presume to speak for all my colleagues throughout the Federal Reserve System, but I do want to use this opportunity to talk with you about some of the problems—here and abroad—that make this an interesting testing period for the usefulness of monetary policy.

Since so much has been written and spoken recently about current business, perhaps you will forgive me if I try merely to touch a few of the highlights. It seems clear that the boom of the past two-and-a-half years has lost much of its strong upward momentum, with private capital outlays and Federal Government expenditures leveling out and perhaps commencing a decline—yet the decline in capital expenditures should be modest, and we are all hearing many public expressions of doubt, enhanced by recent developments in outer space, as to whether the proposed cut in defense spending can or should actually be attained. Exports, which contributed much more than was generally recognized to aggregate demand in 1956 and early 1957, are beginning to show the adverse effects of payments difficulties in many foreign countries. Inventory accumulation is no longer adding force to the boom in any significant degree.

Although industrial production as a whole has been stationary, for all practical purposes, for about a year, the total national product continues to rise slowly, even in physical terms. There is no doubt that business over all is still extremely good, as evidenced by such measures as high employment and personal incomes, and record figures for retail sales. And there appears to be some further upward thrust in State and local government expenditures, to mention one of the expanding sectors.

But there are enough "soft spots" and doubts as to future demand to have caused a good deal of uneasiness among businessmen and economists as to where the economy is going next. It would seem that the greatest change in the last two or three months has been not in business statistics, which on the whole have changed very little, but in business sentiment, which has deteriorated appreciably and has been reflected in the declining trend of stock prices since early summer. This change of sentiment may not last, but to my mind it is a healthy development, if held within reasonable limits, after the rampant optimism of a few months ago.

Meanwhile, what has been happening to commodity prices? The wholesale index has stopped rising, and basic commodities as a group have dropped rather sharply. The index of consumer prices, on the other hand, continues its slow and seemingly inexorable rise, primarily because of increasing prices for services and for food products, and perhaps also reflecting with the usual lag the upward movement of wholesale prices that occurred some months ago. Important wage negotiations are due next year, and if the past gives any indication of the future, industry will again be under pressure to grant wage increases in excess of productivity gains. While we may derive some satisfaction and hope from the slowing-down of the price rise, it is certainly far too early to say that the danger of inflation is past.

Another area we might consider for a moment is that of the demand for and supply of funds. Corporate and municipal bond offerings have been at record levels this

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year, and the calendar for such issues, as you gentlemen are well aware, is still heavy. To some extent these offerings have enabled borrowers to repay old bank loans or to avoid new ones. At any rate, total bank loans have risen much less sharply than a year ago. On the other hand, the Treasury's difficulties in the way of attrition and Savings bond redemptions, while helping to provide funds for the corporate and municipal markets, have also put heavy pressure on the banks as underwriters for the Treasury. A new factor is the prospective shift in the financing of defense procurement contracts from the Treasury to the banks, which will reduce the need for Treasury borrowing but increase the demand for loans. This demand, however, will develop gradually over a period of months, at least insofar as actual drawings are concerned.

The banks, especially those in the chief money centers, are a good deal less liquid than they were a year ago. Consequently, in spite of the slowing-down in the growth of bank loans, the banks in general feel that money is about as tight as it has been at any time in recent years. In contrast, the bond market, which is so sensitive to expectations, as well as to current money conditions, has shown some signs of stabilizing, or even strengthening, in recent weeks. And there have also been encouraging signs suggesting that personal savings may have grown appreciably over the last few months.

The policy of the Federal Reserve System has been to respond to the conditions outlined above with continued steady restraint on bank reserves. I think that in some quarters there have been misconceptions as to this policy. Contrary to some impressions, we have made no attempt to force liquidation of outstanding credit or to interfere with the normal flow of savings into industrial plant and equipment, new homes, or public projects. We have been accused in recent months of intensifying our policy of restricting the availability of credit, and for evidence the finger is pointed at the summer rise in interest rates, including the ½ per cent increase in the discount rate of all the Reserve Banks. Basically it was not so much Federal Reserve policy as the continuing excess of record money demands over available savings, which caused interest rates to go on rising. By refusing to provide the reserves required for a sizable increase in the quantity of money, we of course contributed to the pressure—but when the demand for money continues to increase, interest rates tend to continue to rise, even if our action consists only in limiting the increases in the supply. We have not intended and do not now intend to intensify pressures in the money market, and the way in which during August the discount rates of the various Reserve Banks followed the increases in market rates, rather than leading them, should have demonstrated this pretty clearly.

Incidentally, I should like to stress that no single statistical series can give an adequate measure of the degree of real tightness in the money and capital markets. There is always grave danger of reading too much significance into changes in the week-to-week level of net borrowed reserves without giving enough attention to other factors such as the various market rates of interest themselves, the geographical distribution of reserves, the concentration of money market pressures evidenced by the financing problems of the Government securities dealers, and, more generally, the "feel" of the market—including your own evaluation of the supply-demand factors in the capital market.

I hope you agree that it would be a great mistake to relax credit restraint just as we see some hope of achieving the price stability that we have all sought so ardently. The moderate excess capacities that have appeared in several industries, no doubt at least partly as a result of the recent vast capital expenditures, are the best ally we could have in seeking this goal. They should permit the normal forces of competition to become increasingly effective and to put a check to further price increases. Profits may be squeezed somewhat in the process, but ultimately such a sequence of events should not be without a restraining effect on further wage boosts that cannot be absorbed through increases in productivity.

While there have been many complaints of the uneven impact of our policies on specific segments of the economy, the fact remains that the country has continued to enjoy high levels of prosperity. So long as the economy could not do everything that all of us were trying to make it do, all at once, there had to be some restraint somewhere. There should have been no serious concern when the effects of such restraint actually became visible. The only serious question would have been whether the impact was distributed in a manner that was arbitrary and out of keeping with the market processes of a free economy. On that score, I suggest that the record is about as good as frail human beings could hope for. Moreover, while we may not have succeeded fully in checking inflation, we seem to be achieving at least partial success. There are growing signs of public awareness of the inflation threat and encouraging signs of disbelief on the part of the public in the theory that creeping inflation is either desirable or inevitable. Monetary policy cannot take all the credit, but it deserves some of the credit.

It has often been said in the last year or two that monetary policy has been going through a difficult testing period. It is true that it has, and I am not sure that the most difficult test is over. Perhaps too much of the responsibility for combating inflation has been placed on monetary policy. It has had some help from fiscal policy,

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but the budget surplus would have been a good deal more helpful if it had been larger. Similarly, debt management problems might have involved less difficulty both for the Treasury and for the Federal Reserve if the Treasury had not had to make such frequent trips to the market. That frequency, of course, was partly a by-product of the debt limit, as well as of the size of the cash surplus.

The "capital investment boom" has been held partly responsible for the inflationary pressures of the past year or two, but we are now beginning to benefit from the effects of the enormous investment in new plant facilities over this period. Some degree of statesmanship on the part of labor and management will still be a necessary ingredient if the specter of creeping inflation is to be laid completely. However, I see no reason to accept the defeatist argument that the only alternative to creeping inflation is serious recession and unemployment.

Naturally we are gratified by the degree of public acceptance attained by Federal Reserve policies. But we don't know whether the tendency for wage settlements to outrun productivity gains will persist in spite of our steady credit restraint, or whether the cry for relaxation of tight money will be overwhelming if unused resources tend to increase. Premature easing of credit conditions might well nullify such results as we have already achieved in checking inflation. We may face difficult decisions in the year that lies ahead, and I hope we shall continue to receive your moral support as long as you believe that we are on the right track.

The Federal Reserve System has had to concentrate so much attention on the insidious problem of inflation in the last year or two that we may have given the impression that we are unaware of any other problems, real or potential. Such an impression would be wrong. Our policies must always be framed with a view to the dangers of recession as well as those of inflation—but the emphasis necessarily varies with the current environment. Our directives from Congress are couched in pretty general terms, and there is wide room for judgment in deciding how best to gear our actions to the general objective of sustained economic growth—how much weight to give to price developments and how much to signs of greater availability of unused resources. I think we are fully aware that the time may come when it will be necessary and appropriate to follow an entirely different policy from that of the last two-and-a-half years. For example, if the upward trend of prices is stopped, or if the pressure for funds becomes substantially less than it is now in relation to available savings, or if we should be faced with a substantial increase in unused resources of labor and materials, some change of policy would be logical either in intensity or in direction. The occasion for any major move may be some distance ahead of us, and I am making no attempt at a prediction. But we must be as careful to avoid "overstaying" our market as to avoid premature ease of credit. There is always some doubt as to how quick and effective an easing of credit may be in remedying a downward turn in the economy, if the turn reflects a need for fundamental economic readjustments. I merely want to emphasize that we understand that at times a central bank may have to work the other side of the street—and that we also understand that we don't know all the answers, that each business cycle differs greatly from all that have gone before, and that we must always approach our task in all humility.

Up to this point my comments have dealt almost exclusively with the domestic situation. Now a few words on the international outlook. The American economy now plays such a key role in the world economy that the level of our activity affects people everywhere.

All of us who are interested in the achievement of stable and durable trading and investment relationships among the countries of the world must have felt satisfaction in the results of the recent annual meetings in Washington of the International Monetary Fund and the International Bank. In addition to exceptionally able exposition of guiding principles by the heads of the world organizations, the meetings were notable for the unequivocal statements by the British and German Governments of their determination to maintain the present par values of the pound and the Deutsche mark. Already there are signs that this determined attitude, which is further underlined by the British program announced a few days before the meetings, has borne fruit in the form of a cessation of the heavy speculative flow of funds which had tended to cause concern about various European currencies. The underlying trade and payments statistics, while pointing to some imbalance, especially in the matter of a powerfully favorable German position, were never the chief difficulty. Now that the speculative wave has receded, it would appear that the margin of imbalance is relatively small and that appropriate monetary and fiscal measures can restore a balanced position for most of the chief trading countries. The crucial factor will be their ability to cope with their internal problems, which in most countries are mainly problems of inflation induced by excessive spending, both public and private. There are now encouraging signs of success in the curbing of such spending. Some of the less developed countries have the additional problem of foreign exchange earnings diminishing with the declining prices of the primary commodities which they export. These price declines admittedly increase the difficulties of the primary-producing countries, but we should bear in mind that neither these countries nor the world as a whole would benefit in the long run from a departure by any of the

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leading trading nations from a general program aimed at orderly and sustainable growth free of inflationary excesses.

There have been a number of comments recently on the potential danger to this country of our sizable outstanding short-term liabilities to foreign banks, corporations, and individuals, in the sense that their sudden liquidation could cause a heavy drain on our monetary gold stock. It has always seemed to me that these fears have been exaggerated. The growth of these foreign-held dollar balances is really the most convincing evidence we could have of the strength of the dollar and the confidence of foreigners in it. The rest of the free world has, to a considerable degree, willingly made us its banker. We assume this role with assurance because we are ourselves confident of our economic and financial strength, and are aware of the advantages both to ourselves and to foreigners of the development of our market as the world's largest international money market. A very large part of these claims on us constitute official monetary reserves on which the foreign country in question is glad to earn a return, in contrast with unproductive holdings of gold. Also, a large part consists of private working balances which are indispensable to the conduct of business between the United States and other important trading countries. But the main safeguard against a sudden large withdrawal in gold lies in the powerful attraction which American products have for many foreign countries, and in our enormous capacity to export those products.

As an exporter we are at a great advantage because our exports, though large in absolute terms, are still relatively small in proportion to our total capacity to produce, and can be expanded without impinging too greatly on domestic consumption. Also, the American economy is self-sufficient to a high degree so that our exports can expand without requiring a corresponding rise in imports. These factors were pointedly demonstrated by last winter's Suez crisis, the effect of which was to cause foreign countries to draw down their balances not in gold but in American industrial and agricultural products. We took this sudden increase in the demand for our goods in our stride. We can best ensure our continued capacity to export by preventing inflationary forces in this country from putting our goods at a competitive disadvantage. They are not now at a disadvantage, nor do they seem likely to be.

To my mind, the holding of large balances for foreign account is a normal part of the functioning of our international monetary system. It is not only to our great benefit, but a part of our growing world responsibilities, to make this system work smoothly and efficiently. Of course, there are some risks, but there is no country better able to assume them. Moreover, if we manage our affairs so as to maintain a sound and stable dollar, the risks will be small.

Thank you for your courtesy in giving me a welcome chance to talk to you.

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accounts of foreign banks here and into the bank accounts of our own exporters.

No strict rules can be laid down to account for the varying proportion of United States payments to and from individual countries that is made in foreign exchange, but the factors involved include the relative economic importance of different countries, the strength of their currencies, the custom of the trade in certain commodity transactions, the existence of exchange controls in many countries, and the relative stage of development of banking and financial institutions abroad.

With a large number of countries United States trade is carried out almost entirely in dollars; with others, such as the United Kingdom, parts of the sterling area, some Continental countries, and Canada, a much higher percentage is conducted in foreign exchange. In addition to exchange transactions arising from trade, there is often a need for foreign exchange to finance United States direct investment abroad, and to make remittances to foreign countries, while fairly large amounts of foreign exchange are required by United States tourists traveling abroad.

A large number of American firms and individuals are thus involved in one way or another with some form of foreign exchange activity. An American exporter of tobacco, for example, may sell in Britain for sterling, while a wool importer may need sterling to make payment for wool to be imported from Australia. An American firm may need Canadian dollars to expand the operations of its branch in Canada, while at the same time another firm may be anxious to dispose of Canadian dollars earned from a sale to a Canadian importer. Since it would be extremely difficult for each importer who needed foreign exchange to search out an individual exporter who had the proper amount of exchange for sale, the foreign exchange market provides a medium through which these needs can be easily met. Of course, some large international firms are able to use, in their operations abroad, foreign exchange that they may have earned in other transactions, and they consequently may be partially independent of the market.

## Organization of the Market

The New York foreign exchange market can be broadly described as a three-tiered market. At the heart of the market lies the trading between the banks and their commercial customers who are the ultimate users and suppliers of foreign exchange. In New York there are approximately twenty-five banks that maintain deposits abroad to facilitate their dealings in foreign exchange, although the bulk of the business is accounted for by less than half that number. There are also about thirty-five agencies of foreign banks which sometimes add an international flavor to the market through their handling of foreign-owned dollar balances and their close ties to their countries of origin. In addition, there are a substantial number of specialized foreign exchange dealers who trade principally in foreign bank notes. The second tier of the market is represented by the interbank market in foreign exchange conducted through the foreign exchange brokers, and the third by the active trading in foreign exchange by New York banks with banks abroad. The three segments of the market are so closely interwoven, however, that it is difficult, if not impossible, to separate them; taken together, they make up the New York foreign exchange market.

The foreign exchange market, unlike the stock or commodity exchanges, has no centralized meeting place, no fixed opening or closing time, and no formal requirements for participation except the informal acceptance of a code of financial and moral conduct that has evolved out of the working of the market itself. It thus may best be regarded, not as a place, but rather as the mechanism whereby buyers and sellers of foreign exchange are brought together. Buyers and sellers do not ordinarily meet face to face but carry on their trading primarily by telephone, and also by telegraph, cable, or mail.

### The Banks and Their Customers

The commercial banks maintain foreign exchange inventories in the form of working balances with foreign banks, in order to be in a position to meet the needs of their customers. These balances are replenished by the purchases of balances owned by firms, individuals, or other banks; by the sale of dollars to foreign banks that may, for their own purposes, need additional funds in New York; and by the purchase of foreign bills of exchange, travelers' checks, dividend warrants, bond coupons, and the like. In order to handle their foreign exchange business, each of the banks has several traders who do the actual buying and selling; the trading rooms of the banks make up, in fact, the nerve center of the foreign exchange market. In addition, a clerical staff must be maintained to handle the details of the transactions. The activities of the foreign exchange traders are closely linked to the activities of other divisions of the banks' foreign departments where import and export letters of credit, foreign dollar balances, bills drawn on foreigners, and other transactions with foreigners are handled.

In the course of a day's trading activities the banks purchase foreign exchange from some of their commercial customers and sell exchange to others. Purchases of course can be used to offset sales, so that each bank is to some extent a clearing house where liabilities to foreigners and claims on foreigners are matched up. Some of the banks, however, will find that their purchases from exporters are exceeding their sales to importers, while other banks will find themselves in the opposite position. Since the banks do not ordinarily care to tie up their resources by maintaining unnecessarily large foreign exchange balances, and since they obviously cannot sell what they do not have, there has grown up an active market in foreign exchange among the banks in New York. This market has sometimes been referred to as the "wholesale" market in foreign

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exchange, since trades are ordinarily for fairly large amounts and in round numbers. This picture of the interbank market as a wholesale market should not be taken to mean, however, that transactions with a commercial customer may not on occasion be for a considerably larger amount than can be covered in a single transaction in the interbank market.

#### The Banks and the Brokers

The New York banks do not deal directly with one another but use the services of foreign exchange brokers. There are at present eight such brokers in New York, compared with about forty-five in the 1930's when the leading currencies of the world were freely convertible and the exchange market was, as a result, much more active. Some of these brokers tend to specialize in certain exchanges, but all of them handle the leading currencies such as the pound sterling, the Canadian dollar, and the Swiss franc. The brokers are not required to meet any formal or legal requirements in order to operate, nor do they assume any financial responsibility for the transactions which they carry out as agents for the banks. Competition among the brokers is keen, and a broker's chief assets are the skill with which he can carry out operations for the banks and the degree of confidence that the banks feel they can place in him.

The brokers have direct telephone connections with the foreign exchange trading rooms of the leading commercial banks, and are in almost constant contact with the bank traders. Their primary function is to bring together buyers and sellers among the banks, thus enabling the latter to even out their positions. For each transaction that they arrange among the banks, they receive a commission from the selling bank. Use of a broker saves the banks both time and effort. When a bank wants to either buy or sell, it need only inform the broker of the amount it is interested in and the exchange rate at which it is willing to do business. The broker then undertakes the matching-up of the bank's bid or offer in the market, while the bank traders are left free to concentrate on their commercial business.

The interbank exchange market is thus the mechanism whereby excessive purchases or sales of foreign exchange made by individual banks are ironed out. On many occasions, however, the amount of sterling, for example, offered for sale by commercial or other interests in the New York market will exceed the demand, while on other occasions the opposite will be true. The first thing that results from this normal sort of imbalance is that the exchange rate begins to move, rising if the exchange is in good demand and falling if supplies are heavy. These movements themselves may help to correct the imbalance by encouraging or discouraging the entrance of additional buyers or sellers into the market. The banks too may offset, but usually only within narrow limits, such imbalances by adding to or drawing down their own exchange balances.

#### Trading with Foreign Banks

A third, and very important, method of correcting supply and demand imbalances in the New York market is by the purchase of foreign exchange from, or sale to, foreign banks by the New York banks. Foreign banks, operating in their own exchange markets abroad, are of course active dealers in United States dollars, which are, for them, a very important form of foreign exchange. The activities of foreign central banks and exchange authorities are of particular importance in these markets. Entering the market as both buyers and sellers, ordinarily to prevent excessive swings in the exchange rate, they are an ever-present factor and at times may be the most important single element in the market. If a foreign bank needs dollars to meet the requirements of its customers, and if the currency of its country is actively traded in New York, it may in the normal course of its operations offer its currency to a New York bank in exchange for dollars. Similarly, excess purchases of dollars by a foreign bank from its customers may lead it to offer dollars to New York banks, i.e., to demand foreign exchange in the New York market. The initiative for such bank trading between international centers may originate from either the United States or the foreign side, and there is an almost constant exchange of telephone calls, cables, and teletype messages among the banks in leading centers. Through the relations of New York banks with their foreign branches and correspondents the New York foreign exchange market is thus closely linked with exchange markets abroad.

#### The Combined Market

It should not be thought, however, that trading in the New York market follows a neat and orderly pattern whereby New York banks first trade with their commercial customers, then utilize the interbank market to dispose of any net accumulation of exchange, or to make up any deficiency, and finally have recourse to their foreign branches and correspondents if they are not successful in meeting their needs in New York. In actual practice, everything happens at once. Each bank trader is confronted by a constant flow of offers of, and bids for, foreign exchange not only from commercial interests, but also from other banks through the interbank market and by cable from foreign banks. As he sells exchange he must buy in order to make delivery, and as he buys he must sell in order not to accumulate balances. And through it all the exchange rate (the price of the commodity in which he deals) is being pushed first one way, then the other, by the changing balance of all the forces that make up supply and demand in the market. The manner in which the foreign exchange traders try to steer a straight course through these constantly changing tides provides a large part of the fascination of the market for its participants and much of its mystery for the layman.

In addition to servicing the foreign exchange needs of the New York area, the New York market serves as the

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foreign exchange center of the United States as a whole. There is some exchange activity in other cities such as Boston, Chicago, Philadelphia, and San Francisco, where certain banks maintain balances of their own with foreign banks. Trading is hampered in these centers, however, by the absence of foreign exchange brokers and by a smaller volume of commercial exchange turnover. These banks must consequently come to New York to meet some of their foreign exchange needs, either by dealing directly with their New York correspondents or by using the facilities of the New York exchange brokers. The much larger number of inland banks that do not maintain foreign exchange balances abroad or large foreign departments of their own are also able to provide their local customers with foreign exchange facilities through their correspondent relations with the New York banks.

## The Market for Individual Currencies

In order for an active market in a foreign currency to exist there must be both adequate sources of supply of that currency and active demand. The supply and demand need not originate entirely in the country where the market is located, however, since a demand for dollars in London, for example, is quickly translated into a supply of sterling in New York through the highly efficient communications systems that link the leading financial centers of the world. For the major currencies traded in the New York market, such as the pound sterling and the Canadian dollar, the exchange market is such a two-way street. Trading in sterling in the New York market does not merely represent the supply of, and demand for, sterling by Americans, but reflects the many-sided relationships between the pound and the dollar throughout the world.

For some of the less important currencies, however, which are not used in world trade, there is little possibility of an active market in New York. While New York banks do not maintain balances in such currencies, they can nevertheless offer almost any currency in the world for sale to their customers. They can do this because banks in nearly all countries abroad maintain dollar balances with American banks, and the New York banks are able to obtain any of these currencies by dollar credits to these accounts at either fixed or negotiated rates of exchange.

### The Pound Sterling

The pound sterling is by far the most actively traded currency in the New York market. While there are no published figures, the volume of business transacted annually amounts to several billion dollars, and undoubtedly exceeds the turnover of all other currencies combined. It is probably impossible to compare directly the volume of dollar business in the London foreign exchange market with the volume of sterling business in New York, partly indeed because of the very close links between the two markets. It appears, however, that at times the sterling activity in New York exceeds the dollar activity in London, although the total volume of trading in all types of foreign exchange must be considerably greater in London because of that center's close links with the Continent and the overseas sterling area.

There are several "types" of sterling traded in the New York market. These different types arise out of the classification for British exchange control purposes of foreign-owned bank deposits in the United Kingdom, and reflect the fact that, despite the progress made since the war, the pound is not yet formally a fully convertible currency. The market in American-account sterling is by far the most important, and it is to this market that general references to the "sterling market" in New York apply.

American-account sterling is simply the name given to sterling deposits held by residents of the dollar area.[1] Credits and debits to these accounts can be freely made for all current transactions with the sterling area—such as the purchase or sale of goods and services, profits, and other remittances—and transfers can also be freely made to other nonresident sterling accounts. American-account sterling has always been fully convertible, and can be exchanged for dollars in either the London or New York exchange market within the official support limits for the pound of \$2.78 and \$2.82. Another type of sterling fully convertible in the same markets may be held by nonsterling-area residents outside the dollar area. This is the so-called registered sterling, which arises out of the sale of gold or dollars in the London market.

There is a wide assortment of activities that enters into the New York market for American-account sterling, and as mentioned earlier the market is equally affected by the demand for, and supply of, dollars in London. The American and international oil companies play a particularly important role in the market. At times they are large suppliers of sterling from their sterling earnings, and on other occasions they are net buyers of sterling for direct investment, for royalty or tax payments, or for operational expenditures in the sterling area. Substantial amounts of sterling are earned from American sales of tobacco, grain, a wide variety of manufactured goods, and from profits and dividends received on American investments in the sterling area. There is a demand for sterling for purchases of such sterling-area exports as wool, jute, diamonds, tin, and copper, for purchases of a wide variety of British manufactured goods, and for American investment in Britain or the overseas sterling area. There is also a lively two-way activity arising out of the exchange of banking, shipping, insurance, and other services, and from tourism.

Transferable-account sterling is sterling held by residents of countries (except Egypt) outside the sterling and

[1] According to United Kingdom exchange control regulations, American-account countries consist of the United States of America and its dependencies, the Central American and Caribbean republics, Bolivia, Colombia, Ecuador, Venezuela, Liberia, and the Philippines. Canada is classified separately, but Canadian-account sterling is also fully convertible and can be freely transferred to an American-account.

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dollar areas. It can be freely transferred within that area, or used for payments to any sterling-area country; it cannot, however, be transferred to an American account. Because of the usefulness and acceptability of transferable sterling throughout so large a portion of the world, there has grown up an active dollar market for such sterling outside the United Kingdom. The central market for transferable sterling is in Switzerland, but there is active trading in New York also.

To a considerable extent the New York market in transferable sterling is an entrepôt market where supplies originating, say, in Latin America can be matched with demand arising, for example, on the Continent. A few American exporters have at times been willing to arrange to receive transferable sterling in payment for exports to countries outside the dollar area, and there is some American demand for transferable sterling in order to pay for shipping or other services. American banks cannot hold transferable-sterling accounts directly and must carry out any transactions through branches or correspondents located in a transferable-account country. At times there has been a lively demand for transferable sterling by nonsterling-area residents for the purpose of purchasing sterling-area raw materials for transshipment and resale in the United States. Because of the additional cost of transshipment such transactions were only profitable when transferable sterling was selling at an appreciable discount from American-account sterling. Since such transshipments tended to deprive the sterling area of dollar earnings, the British have, since February 1955, maintained the transferable-sterling rate at only a small discount, usually less than 1 per cent, from the market rate for American-account sterling, and this action appears to have largely eliminated such transactions.

A third type of sterling traded in the New York market is securities sterling. Securities sterling arises principally from the sale of foreign-owned sterling securities in the London market. The sterling proceeds of such sales cannot be freely converted into dollars within the official support limits, but they can be freely sold to other foreigners for similar investment in securities. Because of the close link of this kind of sterling to the international securities markets, a large part of securities-sterling transactions is in the hands of specialized securities houses in New York.

Since American-account sterling has always been convertible, the dollar markets for transferable and securities sterling have made the pound sterling, for all practical purposes, a *de facto* convertible currency for all foreign holders, but not at a single rate of exchange. Since both transferable and securities sterling are more restricted in their use, they are traded at a discount from the rate for American-account sterling. Should the United Kingdom make a move to formal convertibility of all foreign-held sterling balances, the transferable-sterling market would, of course, be merged with the market for American-account sterling. This would tend to widen the scope for trading by New York banks since, for example, a shortage of sterling in New York could be met by offering dollars in any of the exchange markets of the world. Should convertibility be extended to capital as well as current transactions, the securities-sterling market would likewise disappear.

#### The Canadian Dollar and Other Currencies

Next to sterling, the Canadian dollar is the most actively traded currency in the New York foreign exchange market. This is not surprising in view of the large volume of trade and the close financial and commercial ties between the two countries. The major feature of the Canadian dollar market in recent years has been the large demand for Canadian dollars resulting from American and other foreign investment in Canada. Direct investment by American firms, purchases of Canadian oil leases, and the intensive use of the New York money and capital markets by Canadian corporations and municipalities have all played an important role in the market. A good part of the heavy investment in Canada by British and Continental investors has also passed through the New York market. Since the market for the Canadian dollar in other leading international exchange markets is not so broad as in the New York market, the demand for Canadian dollars has had to be met partially by offering United States dollars either in New York or in Montreal or Toronto, rather than by offering other foreign currencies for the Canadian dollar directly. On the supply side, the major source of Canadian dollars has come from Canadian importers, reflecting Canada's large trade deficit with the United States.

The bulk of the trading between the United States and the Canadian dollar takes place in Montreal and Toronto. This is not surprising, since the greater part of the trade between the two countries is invoiced in United States dollars, and there are consequently a greater number of Canadian firms earning and spending United States dollars than there are American firms earning and spending Canadian dollars. New York has established itself, however, as an integral part of the Canadian dollar market, and there is a lively competition between the two markets for the growing volume of business.

Other important currencies traded in the New York market include the Swiss franc, the German "capital" mark (the sole means for investment transactions with Germany), the Dutch guilder, the French franc, the Belgian franc, the free Brazilian cruzeiro, and the free Argentine peso. From time to time there may be important transactions in other currencies as well. Trading in none of these currencies, however, approaches that in the pound or the Canadian dollar. Should the need or the opportunity arise, however, the New York foreign exchange market has the facilities available to expand its trading activities in these or other currencies.

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### The Instruments of the Market

Although the business of the foreign exchange market is, naturally enough, that of buying and selling foreign exchange, the latter is not a homogeneous commodity. Under the term foreign exchange there may be several different forms of short-term monetary claims on foreigners or on foreign banks expressed in terms of foreign currencies. What precisely, then, are the instruments that the banks use when dealing in the market?

Most transactions in the foreign exchange market involve the transfer of a deposit held in a bank abroad. The major instrument for effecting these transfers in the New York market, as in other leading exchange markets throughout the world, is the cable (telegraphic) transfer. A cable transfer is nothing more than an order sent by cable to a foreign bank holding an account for the seller of a particular currency, directing that bank to debit this account and credit the account of the buyer, or the account of the person designated by the buyer, with a specified amount. Thus, a United States exporter or other holder of a foreign exchange balance of, say, £100,000 might sell a cable transfer to a bank in New York; i.e., he would cable his bank in London to transfer £100,000 to the account of the New York bank, and would receive the dollar equivalent of £100,000 at the going market rate from the bank in New York on the same day that the sterling balance changes hands. If the exporter does not maintain a sterling account of his own in a London bank, he might merely cable the British importer from whom payment is due to make payment to the account of the New York bank purchasing the exchange. When a New York bank sells a cable transfer to an importer, it directs its correspondent in London to transfer the sterling amount from its account to the account of the importer, or to the person designated by the importer, and collects the equivalent amount of dollars from the importer.

The chief advantage of the cable transfer lies in the speed with which it can be effected. Normally these transfers are completed on the day following their purchase or sale, but same-day transfers may in some cases be arranged. This, of course, permits the payment of exchange abroad to be delayed until very shortly before it is due, if that is practicable, and also allows a holder of a foreign exchange balance to sell it and receive dollars almost at once. In either case, use of the cable transfer avoids the necessity of tying up funds in foreign exchange, since the dollar payment for cable transfers is made on the same day that the foreign exchange is paid out abroad.

The mail transfer is in every respect similar to the cable transfer, except that the order to the foreign bank to make the transfer is sent by mail rather than by cable. Before the almost universal use of air mail, mail transfers usually commanded a somewhat lower price than cable transfers, since the seller had the use of his funds abroad until the mail order arrived. There is now often no difference in the rates quoted by the banks for air mail and for cable transfers.

In some cases a remitter of funds to someone abroad may want to make his payment directly to the firm or individual without going through a foreign bank. In such cases New York banks sell the remitter a draft on the banks' balance abroad. This is, of course, nothing more than a written order from the New York bank to the bank holding its account abroad to make a specified payment to a designated person or firm upon presentation of the draft. The remitter himself then mails the draft to the beneficiary abroad, who is able to cash it as he would any other check.

#### Bills of Exchange

In addition to the trading in bank balances through the purchase and sale of cable and mail transfers and bank drafts, there are sometimes available in the market various types of foreign bills of exchange. A bill of exchange is defined by the Uniform Negotiable Instruments Act as:

> an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer.

Although the check is a special type of bill of exchange, the term "bill of exchange" almost always refers to commercial and bankers' bills and acceptances. In international trade, commercial bills arise whenever an exporter draws a draft directly on the foreign importer for the amount of the export. Bankers' bills and acceptances arise, for example, when an importer arranges a letter of credit with his bank, under which the exporter draws drafts on the bank or on one of its correspondents rather than on the importer, thereby giving the exporter a bank undertaking that his draft will be honored on presentation. The bills may be payable on sight or at so many days (30, 60, 90, or 180) after sight. Bills may be "clean", if the exporter is willing to turn over title to the goods prior to payment or acceptance of the draft by the importer, but more usually they are "documentary". "Documentary" bills are bills accompanied by documents (such as bills of lading, invoices, shipping and insurance papers, and the like) that carry title to the merchandise covered by the draft. Sight drafts must ordinarily be paid, or time drafts accepted, by the importer (or by his bank if he has arranged a letter of credit in favor of the exporter) before the documents carrying title to the goods are released to him.

Bills of exchange may be drawn in terms of dollars or in terms of foreign currencies, and it is of course the latter in which the New York foreign exchange market is directly interested. On the whole, however, there are very few foreign bills of exchange available in the New York market. Checks drawn by foreigners in their own currencies are not widely used for payment to United States firms and individuals, except for a fairly substantial volume of Canadian dollar checks that are bought by the New York banks for credit to their accounts in Canada. Only a very

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few commercial bills are drawn in terms of foreign exchange, and these are almost always in sterling. There are from time to time a few sterling grain acceptances, but even these are not always presented to the banks for sale, since the exporters often prefer to keep them to maturity (thereby earning the interest on the bills) and then sell the sterling in the form of a cable transfer. There is a somewhat larger volume of letters of credit that provide for drafts to be drawn in foreign currencies, and there are consequently some sterling and other bills drawn on foreign banks that are from time to time offered to the New York banks by American exporters, and some demand for foreign exchange by importers to meet maturing bills.

Most bills of exchange drawn in connection with United States imports and exports are denominated in dollars, and affect the New York foreign exchange market only indirectly. Checks drawn in United States dollars are also used fairly frequently by United States firms and individuals to make payments abroad, particularly for small purchases or remittances. There is little doubt, consequently, that the dollar bill of exchange is of greater importance as an instrument in foreign exchange markets abroad than is the foreign bill of exchange in the New York market. Foreign activity in the New York bankers' acceptance market is one indication of this importance. Not only do foreign banks use the bankers' acceptance market to acquire dollars to meet temporary dollar needs from time to time, but a very large proportion of outstanding dollar acceptances is held for foreign account. The sizable volume of dollar-denominated bills of exchange, some payable by foreigners to Americans and some by Americans to foreigners, makes up a part of the total supply and demand for dollars in exchange markets abroad. In those cases where the foreign exchange markets are closely linked, however, changes in the volume and composition of these dollar instruments may be reflected in changes in the supply of, and demand for, foreign currencies in the New York foreign exchange market as well.

**SELECTED ECONOMIC INDICATORS**
**United States and Second Federal Reserve District**

| Item | Unit | 1957 | | | 1956 | Percentage change | |
|---|---|---|---|---|---|---|---|
| | | September | August | July | September | Latest month from previous month | Latest month from year earlier |
| UNITED STATES | | | | | | | |
| *Production and trade* | | | | | | | |
| Industrial production* | 1947–49=100 | 144*p* | 145 | 144 | 144*r* | − 1 | # |
| Electric power output* | 1947–49=100 | — | 231 | 233 | 219 | − 1 | + 7 |
| Ton-miles of railway freight* | 1947–49=100 | — | 104*p* | 99 | 109 | + 5 | + 1 |
| Manufacturers' sales* | billions of $ | 28.2*p* | 28.6 | 29.0 | 27.1 | − 1 | + 4 |
| Manufacturers' inventories* | billions of $ | 54.1*p* | 54.2 | 54.1 | 50.8 | # | + 6 |
| Manufacturers' new orders, total* | billions of $ | 26.8*p* | 27.3 | 27.3 | 26.8 | + 2 | # |
| Manufacturers' new orders, durable goods* | billions of $ | 12.7*p* | 13.2 | 13.0 | 13.0 | − 4 | − 2 |
| Retail sales* | billions of $ | 16.7*p* | 17.0 | 17.0 | 15.9 | − 2 | + 5 |
| Residential construction contracts* | 1947–49=100 | — | n.a. | n.a. | 250 | n.a. | n.a. |
| Nonresidential construction contracts* | 1947–49=100 | — | 246 | 252 | 251 | − 2 | − 4 |
| *Prices, wages, and employment* | | | | | | | |
| Basic commodity prices† | 1947–49=100 | 87.3 | 89.3 | 90.2 | 91.6 | − 2 | − 5 |
| Wholesale prices† | 1947–49=100 | 118.0*p* | 118.4 | 118.2 | 115.5 | # | + 2 |
| Consumer prices† | 1947–49=100 | 121.1 | 121.0 | 120.8 | 117.1 | # | + 3 |
| Personal income (annual rate)* | billions of $ | 346.5*p* | 346.8 | 346.2 | 331.1 | # | + 5 |
| Composite index of wages and salaries* | 1947–49=100 | — | 157*p* | 157 | 151*r* | # | + 5 |
| Nonagricultural employment* | thousands | 52,682*p* | 52,870*p* | 52,815 | 52,148 | # | + 1 |
| Manufacturing employment* | thousands | 16,692*p* | 16,844*p* | 16,880 | 16,874 | − 1 | − 1 |
| Average hours worked per week, manufacturing† | hours | 40.0*p* | 40.0 | 39.7 | 40.7 | # | − 2 |
| Unemployment | thousands | 2,317 | 2,380 | 2,687 | 1,998 | − 3 | +16 |
| Unemployment‡ | thousands | 2,552 | 2,609 | 3,007 | n.a. | − 2 | n.a. |
| *Banking and finance* | | | | | | | |
| Total investments of all commercial banks | millions of $ | 72,620*p* | 72,760*p* | 72,740*p* | 73,550 | # | − 1 |
| Total loans of all commercial banks | millions of $ | 93,400*p* | 92,880*p* | 92,360*p* | 88,480 | + 1 | + 6 |
| Total demand deposits adjusted | millions of $ | 105,480*p* | 105,110*p* | 106,570*p* | 106,700 | # | − 1 |
| Currency outside the Treasury and Federal Reserve Banks* | millions of $ | 31,112*p* | 31,128 | 31,147 | 30,772 | # | + 1 |
| Bank debits (337 centers)* | millions of $ | 81,281 | 83,608 | 86,073 | 73,717 | − 3 | +10 |
| Velocity of demand deposits (337 centers)* | 1947–49=100 | 148.1 | 146.3 | 149.4 | 135.6 | + 1 | + 9 |
| Consumer instalment credit outstanding† | millions of $ | 33,159 | 33,045 | 32,699 | 30,707 | # | + 8 |
| *United States Government finance (other than borrowing)* | | | | | | | |
| Cash income | millions of $ | 8,115 | 7,104 | 3,615 | 6,877 | +14 | +18 |
| Cash outgo | millions of $ | 6,647 | 7,404 | 7,092 | 5,649 | −10 | +18 |
| National defense expenditures | millions of $ | 3,223 | 4,402 | 4,194 | 3,265 | −27 | − 1 |
| SECOND FEDERAL RESERVE DISTRICT | | | | | | | |
| Electric power output (New York and New Jersey)* | 1947–49=100 | — | 163 | 159 | 152 | + 3 | + 7 |
| Residential construction contracts* | 1947–49=100 | — | n.a. | n.a. | 186 | n.a. | n.a. |
| Nonresidential construction contracts* | 1947–49=100 | — | n.a. | n.a. | 244 | n.a. | n.a. |
| Consumer prices (New York City)† | 1947–49=100 | 118.3 | 118.7 | 118.4 | 115.1 | # | + 3 |
| Nonagricultural employment* | thousands | 7,781.4*p* | 7,810.8 | 7,830.7 | 7,828.3 | # | − 1 |
| Manufacturing employment* | thousands | 2,613.6*p* | 2,630.9 | 2,655.3 | 2,678.9 | − 1 | − 2 |
| Bank debits (New York City)* | millions of $ | 73,909 | 75,175 | 77,614 | 63,774 | − 2 | +16 |
| Bank debits (Second District excluding New York City)* | millions of $ | 5,274 | 5,272 | 5,507 | 4,722 | # | +12 |
| Velocity of demand deposits (New York City)* | 1947–49=100 | 194.3 | 197.3 | 193.9 | 166.8 | − 2 | +16 |
| Department store sales* | 1947–49=100 | 115 | 126 | 120 | 120 | − 9 | − 4 |
| Department store stocks* | 1947–49=100 | 133 | 134 | 136 | 121*r* | − 1 | +10 |

Note: Latest data available as of noon, November 1, 1957.
*p* Preliminary. *r* Revised.
n.a. Not available.
* Adjusted for seasonal variation.
† Seasonal variations believed to be minor; no adjustment made.
‡ New basis. Under a new Census Bureau definition, persons laid off temporarily and those waiting to begin new jobs within thirty days are classified as unemployed; formerly these persons were considered as employed. Both series will be published during 1957.
# 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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