

MONTHLY REVIEW

Of Credit and Business Conditions

FEDERAL RESERVE BANK OF NEW YORK

VOLUME 40

MARCH 1958

No. 3

MONEY MARKET IN FEBRUARY

An easier atmosphere prevailed in the money market during February. Reserve positions of member banks as a whole continued to be relatively comfortable during the four-week period ended February 26, as they were during the latter part of January. On February 19 the Federal Reserve Board of Governors announced a $\frac{1}{2}$ per cent reduction in member bank reserve requirements against demand deposits. For central reserve and reserve city banks the new reserve ratios took effect on February 27, while for country banks the effective date was March 1. This reduction freed approximately 500 million dollars of reserves. The required reserve ratios against net demand deposits are now $19\frac{1}{2}$ per cent for central reserve city banks, $17\frac{1}{2}$ per cent for reserve city banks, and $11\frac{1}{2}$ per cent for country banks. Reserve requirements against time deposits of 5 per cent were not changed.

At times during the early and middle portions of February, some temporary money market pressures developed in New York, partly in connection with the Treasury's large-scale refunding operation, as described below. These pressures were short-lived, however, and over the month as a whole the money market was decidedly easier than in any month in recent years. On most days, Federal funds were readily available at rates well below the $2\frac{3}{4}$ per cent effective ceiling set by the discount rate prevailing in most Districts. Two Federal Reserve Banks reduced their discount rates by $\frac{1}{4}$ per cent to $2\frac{3}{4}$ per cent during the month, thus joining the nine Reserve Banks that had taken this step in January. The reductions took effect at the Minneapolis Reserve Bank on February 7 and at the Dallas Bank on February 14. At the month end, only the San Francisco Bank continued to post a 3 per cent rate.

The net effects of market forces that influence reserves were in close balance during the February statement weeks, following the major changes that had worked through by late January. The Federal Reserve System intermittently released and absorbed reserves, showing little net change in its Government securities holdings. This was in sharp contrast to the System's net sales of almost 600

million dollars of Government securities during February 1957. Reflecting the easier reserve position, on average, during the four statement weeks that ended in February, member bank borrowings from the Federal Reserve Banks dropped to a daily average of 245 million dollars. This was the lowest level for any comparable period in over three years. At the same time, average free reserves climbed to a three-year high of around 245 million dollars, reflecting average excess reserves of 490 million.

Treasury bill rates rose in the early part of February but then declined sharply to close the month well under the low level reached in late January. At the same time, a number of short-term rates such as those on commercial paper and bankers' acceptances declined further, and at the month end were at the lowest levels since August 1955. In the market for longer term securities, prices of Treasury issues strengthened over the first half of the month, paced by the favorable reception accorded the new 32-year $3\frac{1}{2}$ per cent bond. There was some fluctuation in the latter part of the month, but the earlier gains were largely maintained. Even the Treasury's announcement on February 20 that it would shortly seek to raise about $1\frac{1}{4}$ billion dollars through a new bond of around nine-year maturity led to only a moderate and quickly reversed price decline. In corporate and municipal markets, investors offered some resistance to the heavy volume of February offerings, especially of municipals, while prices of seasoned issues declined.

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Table I
Changes in Factors Tending to Increase or Decrease Member
Bank Reserves, February 1958

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

Factor	Daily averages—week ended				Net changes
	Feb. 5	Feb. 12	Feb. 19	Feb. 26	
<i>Operating transactions</i>					
Treasury operations*	+ 159	+ 129	- 154	- 12	+ 122
Federal Reserve float	- 116	- 10	+ 261	- 102	+ 33
Currency in circulation	+ 46	- 96	+ 33	+ 99	+ 82
Gold and foreign account	+ 19	- 18	- 52	- 18	- 78
Other deposits, etc.	- 73	- 103	- 45	+ 19	- 202
Total	+ 27	- 99	+ 42	- 12	- 42
<i>Direct Federal Reserve credit transactions</i>					
Government securities:					
Direct market purchases or sales	- 14	- 29	- 7	+ 95	+ 45
Held under repurchase agreements	+ 6	+ 87	- 42	- 88	- 37
Loans, discounts, and advances:					
Member bank borrowings	- 106	+ 97	+ 75	- 208	- 142
Other			1		1
Bankers' acceptances:					
Bought outright				+ 1	+ 1
Under repurchase agreements	- 4				- 4
Total	- 119	+ 156	+ 26	- 201	- 138
Total reserves	- 92	+ 57	+ 68	- 213	- 189
Effect of change in required reserves†	- 5	+ 53	+ 37	- 4	+ 81
Excess reserves†	- 97	+ 110	+ 105	- 217	- 99
Daily average level of member bank:					
Borrowings from Reserve Banks	189	268	361	153	247‡
Excess reserves†	410	520	625	408	491‡

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 February 26.

BANK RESERVE POSITIONS

As noted earlier, member bank free reserves rose to a daily average of about 245 million dollars during the four statement weeks ended February 26. The banks maintained average excess reserves of around 490 million dollars, or somewhat less than in January, but they were able to cut their average borrowings by more than one half to 245 million dollars. As an additional measure of the banking system's increased liquidity and greater credit potential, it may be noted that total member bank reserves during February averaged about 19,020 million dollars, compared with about 18,825 million a year earlier; in January total reserves averaged about the same as a year earlier.

Early in the month, Treasury deposits with the Reserve Banks fell sharply, thus furnishing a sizable block of reserves to member banks. A further boost to bank reserves in early February was provided by the continued inflow of currency (the record post-Christmas inflow had already added about 1½ billion dollars to reserves in January). Later, toward the middle of the month, the Treasury monetized 100 million dollars of its so-called free gold, using the proceeds of this transaction to bolster its balance with the Reserve Banks.

Other factors, such as a decline in float and increases in "other" deposits, were withdrawing reserves over the first part of February, however. Thus, even though member banks cut their average borrowings from the Reserve Banks below 200 million dollars in the first week of the month, borrowings were increased again toward the middle of February. Simultaneously, an active demand developed for Federal funds and Treasury bill rates advanced. These money market pressures tended to be concentrated in New York, where banks were extending credit to Government securities dealers against "rights" to the midmonth Treasury refunding. The exchange was generally successful, but the substitution in some cases of longer term issues for the maturing short ones resulted in considerable shifts in the ownership pattern. In turn, this led to active trading in "rights", and to loans against rights that sometimes strained reserve positions of the money market banks.

During the latter half of the month, member bank reserve positions continued easy for the country as a whole and the money market atmosphere also became easier again after a letup in the pressures on New York City banks. The midmonth increase in float, which was unusually large for February because snowstorms delayed the routing and processing of checks, more than offset the reserve effects of a replenishment of Treasury deposits, while renewed currency inflows also released reserves. (The lowering of reserve requirement ratios did not begin to apply until February 27 and thus did not affect reserve positions in the statement weeks covered here.) In the final week of February, member banks sharply reduced their debt to the Reserve Banks to a daily average of only 153 million dollars—the lowest for any week since late in 1954.

GOVERNMENT SECURITIES MARKET

Market developments during the first half of February mainly reflected the favorable investor reaction to the Treasury's exchange offering. Subscription books were open from February 3 to 5, and during this period the holders of 15.3 billion dollars of the 16.8 billion of eligible issues chose to exchange into the new securities. The 15.3 billion total included 9.8 billion dollars of the 2½ per cent one-year certificate, 3.8 billion of the 3 per cent bonds of 1964, and 1.7 billion of the 3½ per cent bonds of 1990. In view of the size and complexity of the operation, the "attrition" on the exchange was quite low.

A further measure of the success of the refunding was the fact that the new securities immediately moved to premium quotations in active "when-issued" trading. By February 14, the actual exchange date, the 32-year bond carried a premium of about 3 points. Paced by these advances, other bonds and notes also scored price gains over the first half of the month.

Prices of the longer issues fluctuated during the latter part of the month, but in the intermediate and shorter range there were continued gains. The announcement of lower reserve requirements provided only a modest stimulus to prices, mainly because such a move had been anticipated for some time and its magnitude was less than had been expected in some quarters. On the other hand, prices dropped only briefly on February 21, following the announcement of the Treasury's new cash offering. Over the entire month, price increases for notes and bonds were mainly in the neighborhood of $\frac{1}{2}$ point to $1\frac{1}{2}$ points, with intermediate maturities showing some of the largest gains. The new 32-year bond closed the month at a premium of $2\frac{5}{8}$ points.

Detailed terms of the Treasury's new cash offering for about $1\frac{1}{4}$ billion dollars were announced after the close of the market on February 25. The maturity was set at just under $8\frac{1}{2}$ years, and the interest rate at 3 per cent. Subscription books were open on February 28 and the delivery date is March 10. The new bonds may be paid for by credit to Treasury Tax and Loan Accounts, but subscriptions by commercial banks for their own account were restricted to 25 per cent of the combined capital, surplus, and undivided profits of the subscribing bank.

In late January and early February, Treasury bills were in heavy demand, partly reflecting reinvestment by sellers of "rights" in the midmonth refunding. In February's first auction the average issue rate was 1.58 per cent—down sharply from 2.20 per cent a week earlier. Toward the middle of the month, demand for bills slackened somewhat. The closing of subscription books on the Treasury's exchange offering removed sellers of "rights" as a source of demand, while the temporary tightening of reserve positions in New York caused some banks to sell bills. In the next two auctions, the average issuing rate was 1.73 per cent. Later in February, bill rates dropped abruptly again, broadly paralleling the trend in late January. The sharp rise in demand appeared to reflect a number of factors, including the renewed money market easiness and market reactions to the fact that the new Treasury offering was not in the short-term area. The average issue rate in the final auction of the month plummeted to 1.20 per cent. As shown in the chart, this marked a drop of more than 2 percentage points from last October's peak.

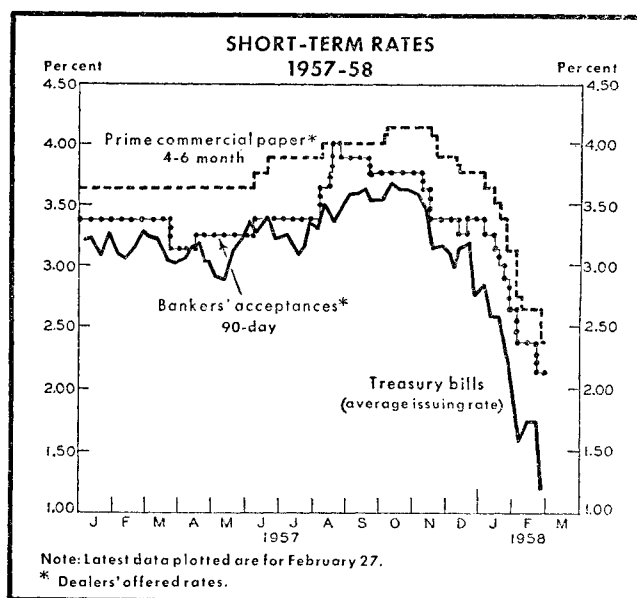
OTHER SECURITIES MARKETS

In contrast to the net price gains recorded by longer term Government securities during February, the markets for corporate and municipal issues were fairly heavy over the month. New offerings continued in large volume, and dealers experienced some difficulty from time to time in moving issues into investors' hands. Even the announcement of

lower reserve requirements stimulated only a moderate reduction in dealers' holdings. No serious congestion developed, however, although price concessions were made in some cases.

New corporate offerings in February totaled an estimated 390 million dollars, not far below the 430 million in January. Investor response was mixed, depending on the yields available. Thus, a large sales finance company issue was well received when reoffered to yield 4.10 per cent, but two issues of Aa-rated utility bonds around midmonth moved slowly when reoffered to yield 3.80 per cent, even though this was 20 basis points above a similar offering in the second half of January. Later in the month, two other Aa-rated issues were marketed at reoffering yields of 3.95 and 4.00 per cent and these issues, too, did not meet with much investor enthusiasm. Yields on seasoned issues showed comparatively little change during the month, however. Moody's yield average for top-rated corporates was 3.61 per cent at the end of February, compared with 3.58 per cent a month earlier.

New issues by various State and local authorities during February totaled some 825 million dollars. This was a record for any month, topping the January figure by about 150 million and the year-earlier total by roughly 350 million. Here, too, market response was mixed as investors resisted offerings that were considered too low in yield. For example, a high-rated State issue maturing 1985-95 was well received early in the month at reoffering yields of 2.85-3.10 per cent, but this yield was appreciably higher than on a similarly rated State issue in January. Yields on seasoned high-grade municipal issues changed



little during the first few weeks of the month but rose significantly in the latter part. Moody's yield average moved up from 2.68 per cent in late January to 2.76 per cent near the end of February.

Interest rates on short-term private debt instruments continued to drop sharply during February. On February 3, the day the Treasury bill issue rate fell to 1.58 per cent, major sales finance companies announced a ½ per cent reduction on rates for all maturities of directly placed paper, and a further ¼ per cent reduction was made a week later. On February 26, following a new downswing in Treasury bill rates, the rates on finance company paper were cut again, bringing the rate on 30 to 89-day paper to 1¾ per cent. Dealer rates on commercial paper were reduced by ⅜ per cent on February 4, by another ⅛ per cent on February 10, and twice more by ⅛ per cent each on the 25th and 26th. The dealers' offered rate on prime 4 to 6-month paper was thus pared to 2¾ per cent. As indicated in the chart, this rate has dropped by 1¾ per cent in the past few months.

Dealers in bankers' acceptances also announced further reductions in quoted rates: ¼ per cent on February 4, on February 21, and on February 28. These reductions placed the dealers' offered rate on 1 to 90-day acceptances at 1⅞ per cent (and the bid rate at 2 per cent).

MEMBER BANK CREDIT

During the four weeks ended February 19, loans and investments of the weekly reporting member banks increased by 500 million dollars, principally reflecting additions of 750 million dollars to investment holdings, while loans declined on balance by 250 million dollars.

The chief source of weakness in loans during recent weeks has been the continued decline in business borrowing. Business loans of the weekly reporting banks decreased in three of the four latest weeks, and the net drop over the first seven weeks of this year, as indicated in Table II, was nearly 1,800 million dollars. To be sure, much of this drop was seasonal, but in the comparable

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. 31, 1957 to Feb. 19, 1958
	Jan. 29	Feb. 5	Feb. 12	Feb. 19	
<i>Assets</i>					
Loans and investments:					
Loans:					
Commercial and industrial loans.....	- 218	- 214	- 100	+ 126	- 1,788
Agricultural loans.....	- 1	+ 10	- 4	- 5	+ 2
Securities loans.....	- 179	+ 584	+ 66	- 281	- 205
Real estate loans.....	- 9	- 12	+ 6	- 1	- 24
All other loans (largely consumer).....	- 21	+ 119	- 15	- 95	- 213
Total loans adjusted*.....	- 428	+ 481	- 47	- 257	- 2,236
Investments:					
U. S. Government securities:					
Treasury bills.....	+ 42	+ 27	- 58	- 146	- 634
Other.....	+ 20	+ 340	+ 81	+ 285	+ 663
Total.....	+ 62	+ 367	+ 23	+ 139	+ 29
Other securities.....	+ 32	+ 51	+ 114	- 11	+ 247
Total investments.....	+ 94	+ 398	+ 137	+ 128	+ 276
Total loans and investments adjusted*.....	- 334	+ 879	+ 90	- 129	- 1,960
Loans to banks.....	- 168	+ 247	- 171	- 100	+ 727
Loans adjusted* and "other" securities.....	- 396	+ 512	+ 67	- 268	- 1,999
<i>Liabilities</i>					
Demand deposits adjusted.....	- 422	- 254	- 332	- 666	- 2,005
Time deposits except Government.....	+ 198	+ 325	+ 318	+ 171	+ 1,262
U. S. Government deposits.....	+ 194	+ 370	- 196	+ 921	+ 346
Interbank demand deposits:					
Domestic.....	- 249	+ 429	- 155	- 33	- 1,812
Foreign.....	- 21	- 32	- 16	- 6	- 214

* 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.

period of 1957 the net decline was less than 800 million and in 1956 it was 400 million. A sizable part of the sharp business loan decline this year reflects the larger-than-usual repayments of bank loans by sales finance companies. In turn, this was related to the fact that sales finance firms were able to obtain a larger volume of credit at lower rates through direct placement of short-term paper. Most other groups of business borrowers have also made larger-than-usual net repayments to the banks thus far in 1958. Inventory reduction is frequently mentioned as the reason for the decline, although in some cases the repayments may have resulted from a funding of short-term debt and other factors.

INTERNATIONAL MONETARY DEVELOPMENTS

MONETARY TRENDS AND POLICIES

The maintenance of credit restraint has continued in recent weeks to dominate the monetary scene in a number of countries.

United Kingdom. The British authorities last month reaffirmed their determination to retain their present restrictive policies as long as necessary. The Chancellor of the Exchequer declared that "tight control on money and

credit at home must certainly continue for the present", and that the government had limited its own demand "to a greater extent than has been realized". He also predicted that restraints could be relaxed once it was evident that wage settlements were not going to drive up prices further. His views were echoed ten days later by the Governor of the Bank of England, who stated that the bank wholeheartedly supported the Chancellor's declaration "that the battle against inflation was only half won and that the

general lines of policy laid down last September must be maintained until that half was converted into a whole”.

Support of the government's anti-inflationary measures of last September and stress on the need to contain excessive wage demands are also apparent in the first report (published on February 21) of the Council on Prices, Productivity, and Incomes, which is under the chairmanship of Lord Cohen and also includes Sir Dennis Robertson. The report not only terms the government's measures “justified and indeed overdue”, but also welcomes the emphasis laid on the importance of re-establishing effective control over the quantity of money. In discussing the steps taken last September, the most dramatic of which was the increase in the Bank of England's discount rate to 7 per cent from 5, the report concludes that the authorities were right to emphasize that the object of these measures was not merely to correct the country's international reserve position, but also to influence domestic prices and costs.

At the same time, the authorities are continuing their policy of funding, in order to reduce the size of the floating debt and thus cut down the clearing banks' liquidity. In mid-February the Treasury issued a 300 million pound, 5½ per cent Funding Loan 1982-84, for cash payment at 1½ per cent discount. Two special features of the loan that are of interest to foreign investors are the permission for nonresidents to purchase the issue with securities sterling and the exemption from British income taxes of the interest paid to such buyers. In floating this issue the authorities were taking advantage of a revival in the gilt-edged market that had lowered the yield of 2½ per cent Consols to 5.13 per cent on February 6 and 7, from 5.17 on January 31 and 5.37 at the end of 1957; on February 28, the yield stood at 5.10 per cent. The market also continued to bid up the price of Treasury bills despite the fact that money market stringency forced the discount houses into the Bank of England on several occasions during the month. As a result, the average Treasury bill tender rate fell to 5.97 per cent at the third February tender; it rose again to 6.01 per cent at the last tender of the month.

France. The French National Credit Council on February 7 set a ceiling on the amount of short and medium-term credit that French banks may extend to the private sector. The ceiling was set, for each individual bank, at the average of the volume of short and medium-term credit outstanding on September 30 and December 31, 1957. Within this ceiling, each bank will be permitted to open lines of credit at its own discretion; the banks, moreover, may exceed the limit by 3 per cent for credits extended to finance exports. In view of the level of credit at present outstanding, the council's decision does not appear to involve an immediate contraction of credit, but

rather calls for greater selectivity in the banks' lending policy in the future. The new restriction serves to supplement last year's anti-inflationary measures. These included a raise in the Bank of France's discount rate, in two stages, from 3 per cent to 5, with simultaneous increases in the bank's penalty rates; a 35 per cent reduction, in successive stages during July-December, in the banks' discount ceilings at the Bank of France; and a tightening of consumer credit regulations.

Norway. The Bank of Norway and the Norwegian Finance Ministry, on the one hand, and the commercial and savings banks, on the other, in mid-January extended their gentlemen's agreement on loans and advances; during 1958 these are not to exceed last year's level. The central bank had declared itself well satisfied with the operation of the original agreement (which had been effective in 1956 and 1957), despite a slight increase in loans above the agreed amount. In announcing the renewal, the Bank of Norway noted that, when it was considering the need for continued restriction of bank-financed demand, it had taken account of the continued high level of economic activity in Norway, which has been accompanied by a shortage of labor, particularly in skilled occupations, and by a persistent upward trend in domestic prices. The bank stated, however, that the agreement was aimed, not at curtailing credit essential for current production, but rather at limiting new investment that might affect the balance of payments unfavorably.

New Zealand. The New Zealand trading banks last month were requested by the Minister of Finance to cut their advances by some 10 per cent by the end of June; the banks are to give preference to loans for essential production and particularly for exports. The reduction, which would bring bank lending back to the level of June 1957, is intended to curtail domestic spending, and follows in the wake of the recent reimposition of quantitative import controls; the latter, in the words of the Finance Minister, are likely to remain “for some considerable time”. These restrictions on both domestic and import expenditures are a response to the recent drop in New Zealand's international reserves and the prospects of reduced export earnings in 1958.

Canada. In Canada, the trend toward monetary ease that had become apparent in the closing months of 1957 continued in January and February. The slower pace in Canadian economic activity, as evidenced by the slackening in nonresidential building and by sharply increased layoffs in manufacturing, has led to a more-than-seasonal decline in the chartered banks' business loans, which fell 74 million dollars or 2 per cent in the eight weeks ended February 19. This decline is clearly not attributable to any tightness in the banks' reserve posi-

tions, since their cash and liquid-asset ratios continue comfortably above the required minima and they have not borrowed from the Bank of Canada since August. In view of this easy liquidity position, the chartered banks have been channeling some of their available funds into government bonds, the increase in their portfolios amounting to almost 200 million dollars or 11 per cent between the end of 1957 and mid-February. As a result, government bond yields declined somewhat in the second half of January. In the short end of the market, the average Treasury bill tender rate declined to 2.99 per cent at the first February tender, rose slightly in mid-February, and again fell to 2.86 on February 27, perhaps partly in response to the fall in the United States bill rate. In line with this decline, the chartered banks last month reduced their prime loan rate to $5\frac{1}{4}$ per cent from $5\frac{1}{2}$, which had been in effect since early December.

EXCHANGE RATES

Commercial demand and a favorable market reaction to the 131 million dollar increase in the United Kingdom's gold and dollar reserves during January held the quotation for American-account sterling at the $\$2.81\frac{3}{4}$ level until February 6, when it moved down to $\$2.81\frac{2}{3}$ on commercial offerings. By February 10 and 11, however, general covering in New York and offerings of United States dollars in London had firmed the rate to $\$2.81\frac{7}{8}$, the highest level since June 1954. A subsequent weakening to $\$2.81\frac{2}{3}$ on February 14 was attributed to commercial offerings of sterling, the reports of the widening of Britain's trade gap, and the results of the Rochdale by-elections. The quotation then recovered to $\$2.81\frac{7}{8}$ on February 17. On February 21 it turned lower under pressure of sub-

stantial commercial demand for dollars in London, and by February 26 stood at $\$2.80\frac{3}{4}$. At the month end it was quoted at $\$2.81\frac{1}{2}$.

The reported movement of short-term funds to London was associated with a widening in the discounts on three and six months' sterling from $2\frac{3}{8}$ and $4\frac{3}{16}$ cents on February 3 to $2\frac{5}{8}$ and $4\frac{1}{2}$ on February 10 and 14, respectively. The discounts subsequently narrowed to $2\frac{1}{2}$ and $4\frac{1}{2}$ but at the month end stood wider at $2\frac{5}{8}$ and $4\frac{3}{8}$ cents.

Transferable sterling, quoted at $\$2.79$ on February 3, firmed steadily under Continental demand and reached $\$2.79\frac{1}{2}$ on February 19 and 20. After easing to $\$2.79\frac{7}{32}$, the rate recovered on February 28 to $\$2.79\frac{9}{16}$. Investor interest, particularly in an offering of a British oil company and the 300 million pound British Treasury $5\frac{1}{2}$ per cent Funding Loan 1982-84, firmed the securities-sterling quotation from $\$2.74\frac{1}{2}$ early in February to $\$2.79\frac{1}{4}$ by the midmonth. The quotation dipped to $\$2.78$ but at the month end was quoted at $\$2.79\frac{1}{4}$.

The Canadian dollar steadily improved after touching a low of $\$1.01\frac{1}{2}$ on February 4, following the announcement of the calling of general elections in Canada. The recovery at first reflected demand from London and the Continent, and later, Canadian commercial offerings of United States dollars and demand for Canadian dollars in connection with several large Canadian securities issues. The rate reached $\$1.02\frac{1}{2}$ in the morning of February 17, but in the afternoon good commercial demand for United States dollars in Canada caused a rather sharp decline in the quotation, and on the following day Canadian dollars were offered in the New York market at $\$1.01\frac{3}{32}$. The quotation subsequently improved, to close on February 28 at $\$1.02\frac{3}{4}$.

PUERTO RICO'S MONETARY SYSTEM AND ECONOMIC GROWTH

Since the beginning of this year, Puerto Rico has been a part, though a special and in some respects limited part, of the Second Federal Reserve District. This marks another important forward step in strengthening the Commonwealth's monetary mechanism and in integrating the Puerto Rican banking system with that of the United States. The new arrangement follows upon a series of steps taken in recent years to adapt the island's monetary and banking system to the rapidly changing needs of the economy. Notable among these measures are basic revisions in Puerto Rico's banking code, the extension of Federal Deposit Insurance to the island, the improvement of coin and currency-supply facilities, and the establish-

ment of a central clearing mechanism for intra-island checks. All of these measures have tended, directly or indirectly, to reinforce Puerto Rico's financial relationships with the continental United States.

These financial relationships are part of broader political and economic ties with the mainland that were formalized in July 1952 with the establishment of the Commonwealth of Puerto Rico in a free and voluntary association with the United States. Under this compact, Puerto Rico's internal autonomy is safeguarded, while the people of the Commonwealth share with the mainland a common citizenship and currency, a unified customs and defense area, and an interlocking judicial system. Under the long-

honored principle of "no taxation without representation" Puerto Rican residents are, however, exempt from Federal taxation; at the same time, the island benefits from a variety of United States Government services and direct grants, and has access to certain Federal financial institutions, such as the Federal Housing Administration and the Federal farm credit agencies.

The pivotal importance of these special factors in Puerto Rico's economic expansion is set forth below. It should be noted at the outset, however, that Puerto Rico could not have secured the full advantage of the association with the mainland if the Commonwealth Government had not itself shown initiative in pursuing appropriate economic and financial policies. The success of these policies is evident from the sustained expansion in output and employment recorded over the past decade, which has made possible a near-doubling of the island's net income and a remarkable rise in living standards. All this has been achieved in an environment of economic freedom, which in turn has promoted rapid capital formation.

MONETARY RELATIONSHIPS WITH THE MAINLAND

Puerto Rico's monetary relationships with the continental United States have played an important role in enabling the island to share in the mainland's postwar economic expansion. A key element in these relationships is Puerto Rico's common currency with the United States. This, in itself, has greatly facilitated the movement of capital from the United States to the Commonwealth. Another important financial tie arises from the close relationships that the seven Commonwealth-chartered commercial banks maintain with their mainland correspondents.¹ These correspondent relationships are the principal channel through which the local commercial banks replenish their liquidity in case of need. It may also be noted that Puerto Rico's Government Development Bank holds a sizable portfolio of United States Government securities and is authorized to accommodate the locally chartered banks by rediscounting their eligible paper or making advances to them secured by such paper. Although this authority has not been used so far since the credit facilities provided by the mainland correspondents have been adequate, it furnishes a potential channel for providing liquidity to the Puerto Rican commercial banks.

These financial links with the mainland have been an element of strength in the Commonwealth's banking system, and have aided in keeping the island's currency and credit supply abreast of the needs of the growing economy.

¹In addition to the seven Commonwealth-chartered commercial banks operating in Puerto Rico, there are also the branches of two mainland banks as well as the branches of two Canadian banks.

The total amount of dollar notes and coin circulating in Puerto Rico cannot, of course, be determined, but the expansion of commercial bank deposits and loans and discounts provides some indication of the broad movement in the means of payment. During the fiscal years 1950-57,² for example, private deposits in Puerto Rico's eleven commercial banks doubled to a total of 303 million dollars; this expansion is attributable in part to the increasing use of checking deposits on the island. Over the same period, loans and discounts rose more than two and a half times to 291 million. The growth in deposits, however, was accompanied by a sharp decline in commercial bank excess reserves. While such excess reserves at the end of the 1950 fiscal year were more than twice as large as the reserves required under Puerto Rican law, they had dropped to only about one quarter of total required reserves by the end of last September. It may be noted that the Puerto Rican reserve requirements are mainly designed to safeguard commercial bank liquidity; at present, they are fixed at 20 per cent of private demand deposits and do not apply either to time deposits or to government deposits. The legal reserves may include vault cash, balances in other banks, and checks in process of collection and thus, in effect, represent active funds.

This contraction in excess reserves, brought about by the pressure of expanding credit demand, also reflects the reduced need to maintain as high a degree of liquidity as in earlier postwar years. This, in turn, has been the result of the significant steps taken since 1950 to strengthen further the island's banking and currency mechanism and reinforce the financial links with the mainland. Perhaps the most important step has been the extension of Federal Deposit Insurance to Puerto Rican banks in 1950. The insurance of individual deposits up to \$10,000 against loss due to bank failure has considerably bolstered confidence in the Commonwealth's banking system, and thus has contributed both to the marked growth in deposits and to a fuller utilization of the banks' resources.

Another important improvement has been the establishment, at Puerto Rico's request, of a United States Treasury cash depot on the island. This depot, set up in 1952, has assured a ready and adequate supply of currency and coin for the community. As a result, the previous need for Puerto Rican banks to carry large reserves of vault cash has been substantially reduced.

Much progress has also been made since 1952 in streamlining the island's check-clearing mechanism, which has diminished the volume of "float", i.e., uncollected balances. As a result of the joint efforts of the Puerto Rican Government and Federal Reserve technicians, the Com-

²The Puerto Rican fiscal year runs from July 1 to June 30.

monwealth commercial banks devised a clearing system that draws heavily on the experience and techniques developed on the mainland. An agreement has been concluded among Puerto Rican banks setting forth the procedures to be followed in the collection of intra-island checks, and the Government Development Bank has been designated as Settling Agent. An important tie-in with the Federal Reserve System was effected when the Government Development Bank was granted permission to establish a nonmember clearing account with the Federal Reserve Bank of New York. This has greatly facilitated the settlement of balances and their transfer to and from the Puerto Rican banks' New York correspondents. While there is still room for various improvements in these arrangements, the basic clearing mechanism has thus far been found to function effectively and to meet the island's needs. Fundamental revisions have also been made since 1950 in the Commonwealth's banking statute, resulting in improved bank supervision and examination, stronger bank-capital structures, and better safeguards against unsound and speculative banking practices. In 1950, too, the locally chartered banks were specifically authorized to affiliate themselves with the Federal Reserve System, and recently legislation has been introduced in Puerto Rico amending the Commonwealth's banking code so as to exempt the locally chartered banks from local reserve requirements in the event of Federal Reserve membership.

A significant step linking Puerto Rico with the Second Federal Reserve District was taken last January 1 when the island became part of the District for purposes of check collection. This step, which followed the adoption of par clearance of checks by the Commonwealth banks, enhances the mobility of funds between the mainland and Puerto Rico, and makes an additional Federal Reserve service available to the Puerto Rican banking system. The Puerto Rican banks' previous practice of levying exchange charges on checks involving the transfer of funds between the Commonwealth and the mainland, while representing a lucrative source of bank earnings, not only barred the collection of checks through the Federal Reserve System, but also marked Puerto Rico as a "foreign" area. While the elimination of exchange charges involves an estimated loss in gross bank earnings of some \$500,000 annually, this reduction is likely to be offset at least in part by the "repatriation" of deposits previously kept with mainland banks in order to avoid these charges.

ACCESS TO THE MAINLAND CAPITAL MARKET

The close tie-in of Puerto Rico's monetary and banking structure with the mainland, along with the integrated legal and judicial system of the two areas, has greatly facilitated the Commonwealth's access to the United States capital

market. Thus, Puerto Rican Government obligations are traded in the United States on the same tax-free basis as the obligations of the State and local authorities, and private Commonwealth borrowers may enter the United States market for long-term funds on the same basis as mainland borrowers.

This access to the mainland capital market has been a pivotal factor enabling Puerto Rico to finance a very high rate of capital formation, which has averaged about 19 per cent of the gross national product in recent years, and last year reached a peak of 21 per cent. Because of the inadequacy of domestic savings, nearly half of Puerto Rico's annual gross investment expenditures have had to be financed in recent years from external sources, a proportion that compares with an average of about one tenth for the Latin American republics.

The Puerto Rican Government and the island's public authorities have been the principal Commonwealth borrowers in the United States capital market. With the sale of a 10 million dollar government bond issue to a syndicate of New York banks during fiscal 1957, Puerto Rico's net public debt rose to 48.6 million dollars, more than double the amount outstanding in June 1950. While this increase has been significant, the Commonwealth's net outstanding debt is still only 45 per cent of the legal debt limit. Outside this debt limit, Puerto Rican public authorities—notably the Water Resources Authority, the Aqueduct and Sewer Authority, and the Ports Authority—floated long-term issues in the United States during 1956-57 totaling 41.5 million dollars, which brought their aggregate indebtedness to 178 million dollars last June 30.

In addition to the sale of securities in the mainland market, Puerto Rico has also had access to Federal long-term lending agencies operating in Puerto Rico. Thus, the Federal farm credit system has played an active part in extending mortgage and other medium and long-term loans to Puerto Rican farmers. Other long-term credit facilities for the industrial and commercial sector have been provided by the Small Business Administration, which has functioned in Puerto Rico since 1953, and which last year made sizable disaster loans to finance repairs of damage caused by Hurricane Betsy. Moreover, a key factor in attracting a massive inflow of private mainland funds into the financing of private construction has been the Federal Housing Administration, which has made mortgage insurance facilities available in Puerto Rico.

In view of the island's heavy dependence on external capital, efforts are currently being made to develop a local capital market in order to stimulate and mobilize domestic savings, which have been consistently inadequate. Puerto Rican banks have therefore carried on an aggressive and generally successful promotional campaign to encourage

and attract savings. The mobile banking units that have recently been put into operation in order to service the remoter regions of the island may also significantly aid in this direction. Another hopeful development was the formation last December of a Puerto Rican investment company, which will specialize in underwriting and marketing Puerto Rican securities; this company, together with the branch of a mainland investment company that has been established on the island since 1952, is expected to help familiarize the Puerto Rican public with the opportunities of investment in securities.

UNITED STATES GOVERNMENT DISBURSEMENTS

United States Government disbursements have also played a vital part in augmenting the island's income and capital resources. These disbursements arise mainly out of Puerto Rico's special links with the mainland, and consist chiefly of United States Government expenditures on wages and salaries for a wide variety of activities in Puerto Rico, and of veterans' benefit payments, Federal grants-in-aid, and Federal excise tax and customs duty collections, which by agreement revert to the Commonwealth Treasury.

The direct impact of Federal expenditures for the maintenance of defense installations, agricultural and scientific services, and other programs can be gauged by the fact that in fiscal 1957 such payments generated about 7 per cent of the island's net income. These Federal Government disbursements, however, have tended to decline since 1953 when they accounted for about 14 per cent of aggregate Commonwealth income and surpassed both the proportions contributed by manufacturing and by the entire Puerto Rican Government sector. The principal reason for this decline has been the curtailment of United States defense activities. Such expenditures during the last fiscal year dropped about 16 per cent to 75 million dollars.

Federal grants-in-aid have been extended directly to the Puerto Rican Government, and have financed a wide range of outlays, notably road construction, agricultural extension services, and educational and social welfare programs. These grants are extended to Puerto Rico on the same basis as to the mainland States, even though Federal taxes are not levied in Puerto Rico. Such United States Government payments, moreover, have expanded steadily over the past decade, climbing sixfold from about 4 million dollars in fiscal 1947 to nearly 24 million in fiscal 1957. The rising importance of these grants in the Commonwealth budget is evident from the fact that they now account for more than 12 per cent of aggregate revenues, compared with only 4 per cent a decade ago.

Federal excise taxes and customs duties, which under special arrangements between Puerto Rico and the United States are almost entirely turned over to the Common-

wealth Government, last year totaled some 19 million dollars, equivalent to about 10 per cent of the total budget. These receipts, too, have expanded significantly in recent years, and have been derived chiefly from excise taxes on Puerto Rican rum sold on the mainland. In recent years, this tax has added about 15 million dollars a year to Commonwealth Government revenues. Moreover, the fact that Puerto Rico does not have to pay Federal excise taxes on products sold locally, enables the Commonwealth Government to impose taxes on consumption, notably on liquor and tobacco, and thus to increase its revenues. The same holds true for Puerto Rico's exemption from Federal income taxes. Such taxes, if applied, would have drawn substantial funds out of the island, and thus considerably reduced the tax base on which the Commonwealth Government could have relied.

INDUSTRIAL PROMOTION AND TAX EXEMPTION

These substantial benefits accruing to Puerto Rico from Federal disbursements, grants, and tax exemptions have to a large extent been matched by the Commonwealth's own fiscal inducements to prospective local and mainland investors. These inducements are part of a broad program, inaugurated in 1948 under the banner of "Operation Bootstrap", which was designed to promote industrialization. The core of this program has been the tax incentives that the government has offered prospective foreign investors and the special assistance it has provided in planning and setting up new enterprises. The focus throughout the program has been on the promotion of private enterprise, the government confining its activities chiefly to the maintenance of political and financial stability, improving the quality of the labor supply, creating an efficient public administration, constructing factory buildings, and developing basic utilities, notably power and water resources and transportation and communications facilities.

Tax exemptions have been the most potent incentive for both local and other investors, and in their present form relieve qualified enterprises of all insular income and property taxes for ten years. For this purpose, qualified enterprises are defined as those producing items that were not in commercial production on the island prior to January 1, 1947. Since very little manufacturing activity was carried on in the Commonwealth previous to that date, most industries can in practice qualify. A notable exception, however, is that firms that close down their mainland operations in order to establish plants in Puerto Rico are ineligible to benefit from the tax-incentive program; moreover, the exemption privilege may be revoked by the authorities where firms have failed to live up to their stated commitments under the program. The tax inducements are further enhanced by the fact that, in certain

cases, government-constructed factory buildings are leased to enterprises at low rents or are sold to them on very favorable terms. In addition, the Government Development Bank extends medium-term credits to prospective investors for the purpose of acquiring machinery and equipment; and the government frequently finances the cost of training labor for new undertakings. In order to render these incentives most effective, moreover, a vigorous promotional campaign has been carried on by Puerto Rico's Economic Development Administration to bring these advantages before the public eye.

The tangible signs of Puerto Rico's industrialization effort are the more than 500 new factories established on the island since 1947. These firms last year represented an aggregate investment of more than 300 million dollars and employed an estimated 36,000 persons, about 6 per cent of the employed labor force. This process of industrialization has also been marked by an increase in the rate at which new plants have been established. The fact that these industries are largely oriented toward the external market has been of particular importance to Puerto Rico's economic expansion, and such sales have enabled the Commonwealth to pay for an increasing volume of imports, mainly from the United States. In addition, the new industrial undertakings have tended to absorb an increasing number of the Commonwealth's large underemployed labor pool, which has enhanced significantly the general level of productivity and wages. The continuing expansion of manufacturing, moreover, may also reduce the need for Puerto Rico's surplus labor force to move to the mainland in search of employment opportunities.

In the earlier years of "Operation Bootstrap" the firms coming to Puerto Rico had been relatively small, with a heavy concentration in light manufacturing. More recently, however, the program has been attracting larger and more basic industrial undertakings, notably in the fields of chemicals, plastics, and electronics. The recent establishment of two oil refineries, moreover, promises to lay the foundation for petrochemical and related industries based on imported crude oil.

The Puerto Rican authorities have recognized that economic development need not necessarily take the form of industrialization and a proliferation of new factories, but may rather call for improvements in agricultural productivity and a diversification of crops. In the case of Puerto Rico, however, poor soils, climatic conditions, and competition of duty-free imports from the mainland have considerably limited the opportunities for expanding agricultural output; in addition, the Commonwealth's principal export crop, sugar, has been subject for many years to import quotas in the mainland market. Although there has been some progress in recent years in

developing new crops, introducing new methods of farming, and improving marketing facilities, the difficulties in developing agriculture contrast sharply with the existing opportunities for promoting industry. These opportunities lie, quite apart from fiscal inducements, in the island's abundant and adaptable labor supply, the low wage rates, and the tariff-free access to the United States market.

Puerto Rico's economic progress is well evidenced by the near doubling of its net national income over the past decade to more than 1 billion dollars. Adjusted for price changes, this expansion represented a "real" gain of more than 50 per cent. What is even more important, however, is that the increase exceeded the population growth, thus making possible a climb in "real" per capita income to \$424 during the 1957 fiscal year from \$293 ten years earlier, a rise in excess of 40 per cent. At this figure, Puerto Rico's "real" income per head was surpassed in Latin America by only two countries, Venezuela and Argentina.

CONCLUDING COMMENTS

Puerto Rico's economic expansion thus owes much to its particular financial, commercial, and political relationships with the mainland. The advantages of these relationships, however, would have been of little significance without Puerto Rico's own efforts to spur economic development. A vital aspect of these efforts has been the stress on attracting private investment, local and external, and on stimulating private initiative. This stress reflects efforts not only to expand physical productive capacity in a variety of fields, but also to promote the transmission to the island of skills, technology, and enterprise, which are a key to self-sustaining economic growth. A major element in this program has been the creation of a favorable investment climate, based on generous tax exemptions and a wide range of other inducements to new enterprises.

Equally important have been the Commonwealth's efforts to strengthen its financial system and to attune the monetary and banking structure more effectively to that of the mainland. These measures have enabled Puerto Rico to share more fully in the economic expansion and the high level of prosperity that have prevailed in the United States in the postwar period. The closer financial relationships with the mainland, in particular, have aided Puerto Rico in safeguarding its monetary stability and in removing some of the elements that until recently still marked the Commonwealth in some respects as a "foreign" monetary area. In addition, the closer tie-in with Federal financial institutions has promoted a better utilization of liquid bank resources for meeting the needs of the expanding economy.

These programs and policies, although admittedly aided

by special factors, have tended to transform Puerto Rico from a "stricken land" into an increasingly dynamic economy, with a progressively more diversified productive structure. Despite these notable forward strides, however, much still remains to be accomplished to attain fuller and more broadly based economic development, as well as to

raise further the living standards of the rapidly expanding population. Nevertheless, there can be little doubt that over the past decade Puerto Rico has begun to break loose from the proverbial vicious circle of low income, low capital formation, low income, and to lay a foundation for sustained economic growth and social progress.

EARNINGS AND EXPENSES OF SECOND DISTRICT MEMBER BANKS IN 1957

Net profits of Second District member banks during 1957 moved into closer alignment with the earnings rates of banks in the rest of the country. The over-all result in this District amounted to a 7.7 per cent return on average capital invested in 1957, compared with 6.7 per cent in 1956. For all member banks in the country as a whole, 1957 net profits amounted to a return of 8.3 per cent on capital, against 7.7 in 1956.

Net operating income for all Second District member banks rose to 710.1 million dollars in 1957, and net profits to 309.1 million, an increase in the latter over 1956 of 56.6 million dollars. The sustained demand for loans plus higher rates of interest on loans and investments played

an important role in the better earning performance of the banks, but the more marked improvement in net profits than in net operating earnings resulted from smaller net charge-offs on loans and smaller additions to loan valuation reserves than in 1956.

The New York City banks showed a somewhat better percentage increase in net current operating earnings than did the other member banks in the District as a group, and both groups showed a greater increase in net profits during 1957 than did the average for all member institutions throughout the country. Total current operating earnings of both groups of Second District banks were up approximately 12 per cent, but the City banks were able to hold

Earnings and Expenses of Second District Member Banks, Selected Years
(In millions of dollars)

Item	Central reserve New York City banks				Reserve city and country banks			
	1945	1950	1956	1957	1945	1950	1956	1957
Number of banks.....	37	23	18	18	777	728	569	542
Earnings:								
On United States Government securities.....	222.1	144.6	132.9	137.0	81.5	72.9	87.0	94.8
On other securities.....	24.2	31.3	46.9	46.9	10.3	16.0	28.9	34.3
On loans (including service charges and fees on loans).....	105.6	215.1	633.3	727.9	45.2	142.2	319.7	361.4
Service charges on deposit accounts.....	7.5	16.3	24.6	25.6	9.0	19.6	37.0	42.2
Trust department earnings.....	40.7	57.5	104.9	114.6	5.3	8.5	12.9	15.1
Other current earnings.....	32.1	47.4	71.5	85.2	12.9	16.3	23.3	24.3
Total current operating earnings.....	432.2	512.2	1,014.1	1,137.2	164.2	275.5	508.8	572.1
Expenses:								
Salaries and wages—officers and employees.....	116.8	169.7	274.5	293.7	46.4	87.4	152.0	164.6
Interest on time deposits (including savings deposits).....	5.6	9.7	59.1	79.7	23.8	31.7	81.1	111.2
Interest and discount on borrowed money.....	1.0	1.9	13.3	14.8	0.2	0.3	2.2	2.1
Taxes other than on net income.....	10.2	11.8	14.2	15.6	6.0	8.3	12.0	13.4
Recurring depreciation on banking house, furniture, and fixtures.....	4.2	3.5	10.0	11.5	3.7	5.6	11.2	13.0
Other current operating expenses.....	78.6	101.3	164.9	178.3	32.3	56.3	93.2	101.3
Total current expenses.....	216.4	297.9	536.0	593.6	112.4	189.6	351.7	405.6
Net current operating earnings before income taxes.....	215.8	214.3	478.1	543.6	51.8	85.9	157.1	166.5
Net recoveries (+) or charge-offs (-) on loans.....	+ 1.3*	- 2.7	- 29.0	- 8.1	+ 1.2*	- 1.2	- 5.7	- 6.2
Securities profits and recoveries (+) or charge-offs (-).....	+ 100.2†	+ 13.5	- 53.0	- 61.6	+ 26.1†	+ 6.8	- 19.1	- 19.9
All other recoveries (+) or charge-offs (-), net.....	- 12.4	- 3.8	+ 17.1	+ 1.3	- 2.7	- 0.6	- 1.7	+ 3.2
Net additions to (-) or deductions from (+) valuation reserves for:								
Loan losses.....	—	- 14.2	- 65.3	- 36.2	—	- 12.1	- 31.0	- 23.1
Securities losses.....	—	+ 6.9	- 2.2	+ 3.4	—	+ 0.2	+ 1.2	- 0.4
Net profits before income taxes.....	304.9	214.0	345.7	442.4	76.4	79.0	100.8	120.1
Taxes on net income.....	90.7	68.6	156.7	208.8	16.0	23.2	37.3	44.6
Net profits after income taxes.....	214.2	145.4	189.0	233.6	60.4	55.8	63.5	75.5
Cash dividends paid or declared.....	73.0	89.4	133.2	151.7	13.9	20.2	34.3	41.8
Retained earnings.....	141.2	56.0	55.8	81.9	46.5	35.6	29.2	33.7

* Includes transfers to or from valuation reserves for loan losses.

† Includes transfers to or from valuation reserves for losses on securities.

Sources: Board of Governors of the Federal Reserve System, 1945-56; figures for 1957 are preliminary and are compiled by the Federal Reserve Bank of New York.

the increase in their operating expenses to 10.7 per cent, compared with a rise of 15.3 per cent for the rest of the District. The bigger percentage jump in the operating expenses of the reserve city and country banks was due primarily to a larger percentage increase in salaries and wages paid to employees and interest paid on time deposits. Net current operating earnings of all member banks were 6.0 per cent above those of 1956, while those of the District members were 11.8 per cent higher. Net profits, after taxes and all other charges, of the District banks increased by 56.6 million dollars during 1957, compared with an increase of 142 million dollars for the country as a whole.

Both the central reserve and reserve city and country institutions increased their dividend payments in 1957 (as the accompanying table indicates), but the New York City banks cut the proportion of net profits paid out from 70.5 per cent of the total in 1956 to 64.9 per cent in 1957, while the other District member institutions increased the proportion of net profits paid to stockholders from 54.0 per cent to 55.4 per cent.

A more detailed analysis of the earnings and expenses of Second District member banks and additional statistical material may be obtained from the Publications Division, Federal Reserve Bank of New York, New York 45, New York.

SELECTED ECONOMIC INDICATORS
United States and Second Federal Reserve District

Item	Unit	1958	1957			Percentage change	
		January	December	November	January	Latest month from previous month	Latest month from year earlier
UNITED STATES							
<i>Production and trade</i>							
Industrial production*	1947-49=100	133 _p	136	139	146	- 2	- 9
Electric power output*	1947-49=100	—	227	229	227	- 1	+ 1
Ton-miles of railway freight*	1947-49=100	—	94	96	101	- 2	-16
Manufacturers' sales*	billions of \$	—	26.7 _p	27.2	30.0	- 2	- 7
Manufacturers' inventories*	billions of \$	—	53.6 _p	53.9	52.4	- 1	+ 2
Manufacturers' new orders, total*	billions of \$	—	25.2 _p	26.1	28.9	- 3	-13
Manufacturers' new orders, durable goods*	billions of \$	—	11.6 _p	12.4	14.2	- 6	-20
Retail sales*	billions of \$	17.0 _p	16.9 _p	16.6	16.3	+ 1	+ 4
Residential construction contracts* ††	1947-49=100	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Nonresidential construction contracts* ††	1947-49=100	n.a.	n.a.	269	297	n.a.	n.a.
<i>Prices, wages, and employment</i>							
Basic commodity prices†	1947-49=100	84.8	84.7	84.5	91.7	#	- 8
Wholesale prices†	1947-49=100	118.7 _p	118.5	118.1	116.9	#	+ 2
Consumer prices†	1947-49=100	122.3	121.6	121.6	118.2	+ 1	+ 3
Personal income (annual rate)*	billions of \$	343.6 _p	343.6	346.2	338.3	#	+ 2
Composite index of wages and salaries*	1947-49=100	—	160 _p	160	154	#	+ 5
Nonagricultural employment*	thousands	51,735 _p	51,930 _p	52,218	52,493	#	- 1
Manufacturing employment*	thousands	15,973 _p	16,276 _p	16,463	17,053	- 2	- 6
Average hours worked per week, manufacturing†	hours	38.7 _p	39.4	39.3	40.2	- 2	- 4
Unemployment†	thousands	4,494	3,374	3,188	3,244	+ 33	+39
Unemployment	thousands	n.a.	3,140	2,989	2,940	+ 5	+27
<i>Banking and finance</i>							
Total investments of all commercial banks	millions of \$	75,450 _p	75,560 _p	74,260 _p	73,880	#	+ 2
Total loans of all commercial banks	millions of \$	92,110 _p	94,280 _p	93,010 _p	88,930	- 2	+ 4
Total demand deposits adjusted	millions of \$	107,520 _p	108,800 _p	107,190 _p	109,510	- 1	- 2
Currency outside the Treasury and Federal Reserve Banks*	millions of \$	30,904 _p	31,093	30,963	30,886 _r	- 1	#
Bank debits (337 centers)*	millions of \$	84,409	80,826	78,567	83,373	+ 4	+ 1
Velocity of demand deposits (337 centers)*	1947-49=100	143.1	146.3	139.4	141.0 _r	- 2	+ 1
Consumer instalment credit outstanding†¶	millions of \$	—	34,127	33,596	31,568	+ 2	+ 7
<i>United States Government finance (other than borrowing)</i>							
Cash income	millions of \$	4,801	6,622	6,463	4,886	-25	#
Cash outgo	millions of \$	5,940	7,203	6,553	5,599	-18	+ 6
National defense expenditures	millions of \$	4,428	3,694	3,277	3,651	+ 20	+21
SECOND FEDERAL RESERVE DISTRICT							
Electric power output (New York and New Jersey)*	1947-49=100	—	158	157	160	+ 1	+ 1
Residential construction contracts* ††	1947-49=100	—	n.a.	n.a.	n.a.	n.a.	n.a.
Nonresidential construction contracts* ††	1947-49=100	—	n.a.	n.a.	n.a.	n.a.	n.a.
Consumer prices (New York City)†	1947-49=100	120.0	118.7	118.6	115.6	+ 1	+ 4
Nonagricultural employment*	thousands	—	7,668.1 _p	7,728.1	7,855.0	- 1	- 3
Manufacturing employment*	thousands	—	2,519.3 _p	2,547.4	2,696.0	- 1	- 7
Bank debits (New York City)*	millions of \$	81,898	75,071	76,241	74,283	+ 9	+10
Bank debits (Second District excluding New York City)*	millions of \$	5,244	5,057	4,984	5,470	+ 4	- 4
Velocity of demand deposits (New York City)*	1947-49=100	207.3	198.9	197.3	183.6	+ 4	+13
Department store sales* §	1947-49=100	125	123	124	123	- 2	+ 2
Department store stocks* §	1947-49=100	137	138	138	138	- 1	- 1

Note: Latest data available as of noon, March 3, 1958.

p Preliminary.

r Revised.

n.a. Not available.

* Adjusted for seasonal variation.

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

Change of less than 0.5 per cent.

†† Series discontinued.

Source: A description of these series and their sources is available from the

‡ New basis. Under a new Census Bureau definition persons laid off temporarily and those waiting to begin jobs within thirty days are classified as unemployed; formerly these persons were considered as employed. Both series are available for 1957.

§ Revised series. Back data available from the Financial and Trade Statistics Division, Federal Reserve Bank of New York.

¶ Revised series. Back data published in *Federal Reserve Bulletin*, December 1957.

Domestic Research Division, Federal Reserve Bank of New York, on request.

Earnings and Expenses of Second District Member Banks in 1957

(Supplement to the article entitled "Earnings and Expenses of Second District Member Banks in 1957" printed in the March 1958 issue of the Monthly Review of Credit and Business Conditions, Federal Reserve Bank of New York)

Net profits of Second District member banks during 1957 moved into closer alignment with the earnings rates of banks in the rest of the country. The over-all result in this District amounted to a 7.7 per cent return on average capital invested in 1957, compared with 6.7 per cent in 1956. For all member banks in the country as a whole, 1957 net profits amounted to a return of 8.3 per cent on capital, against 7.7 in 1956.

Net operating income for all Second District member banks rose to 710.1 million dollars in 1957, and net profits to 309.1 million, an increase in the latter over 1956 of 56.6 million dollars. The sustained demand for loans plus higher rates of interest on loans and investments played an important role in the better earning performance of the banks, but the more marked improvement in net profits than in net operating earnings resulted from smaller net charge-offs on loans and smaller additions to loan valuation reserves than in 1956.

The New York City banks showed a somewhat better percentage increase in net current operating earnings than did the other member banks in the District as a group, and both groups showed a greater increase in net profits during 1957 than did the average for all member institutions throughout the country. Total current operating earnings of both groups of Second District banks were up approximately 12 per cent, but the City banks were able to hold the increase in their operating expenses to 10.7 per cent, compared with a rise of 15.3 per cent for the rest of the District. The bigger percentage jump in the operating expenses of the reserve city and country banks was due primarily to a larger percentage increase in salaries and wages paid to employees and interest paid on time deposits. Net current operating earnings of all member banks were 6.0 per cent above those of 1956, while those of the District members were 11.8 per cent higher. Net profits, after taxes and all other charges, of the District banks increased by 56.6 million dollars during 1957, compared with an increase of 142 million dollars for the country as a whole.

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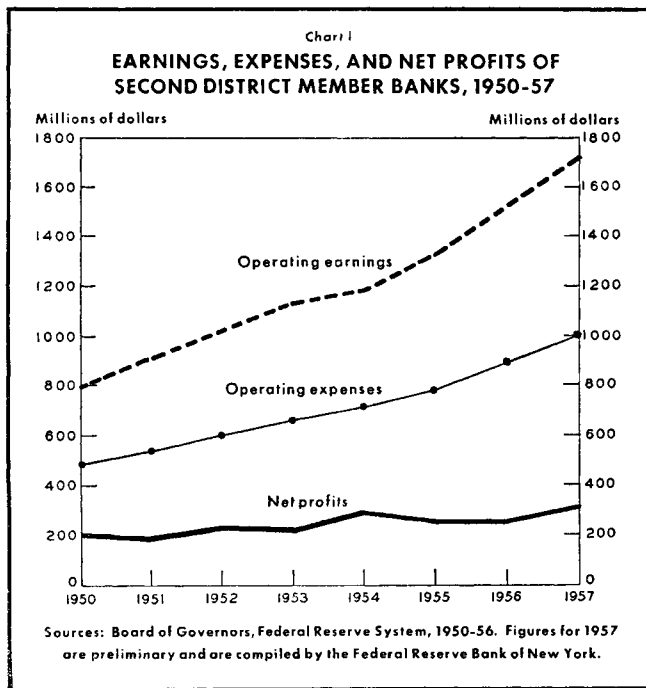
banks cut the proportion of net profits paid out from 70.5 per cent of the total in 1956 to 64.9 per cent in 1957, while the other District member institutions increased the proportion of net profits paid to stockholders from 54.0 per cent to 55.4 per cent.

OPERATING INCOME

A high level of loans outstanding throughout 1957 was in part responsible for the new peak in current operating earnings of 1,709.3 million dollars achieved last year by Second District member banks (see Chart I). In addition, the general level of interest rates in 1957 was higher than at any time since the early 1930's. The rate of increase in the average amount of loans of member banks outstanding in the Second District was slower, however, during 1957 than in 1956. In 1956 the average amount of loans on the books of the City banks increased by 1.9 billion dollars for a gain of 14.3 per cent, but in 1957 they increased by only 764 million (4.9 per cent). Reserve city and country banks increased their average loans outstanding by 700 million (13.7 per cent) and 483 million dollars (8.0 per cent), respectively. The slower rate of increase last year in the average amount of loans was accompanied by a smaller decline in investments, 465 million dollars for 1957, compared with 2.3 billion dollars for 1956. During 1957, reserve city and country banks, which added 483 million dollars to their average loan volume, increased their average investments by 88 million dollars.

The increase in the average amount of outstanding loans at all Second District member banks in 1957 was due primarily to the expansion (1) of 1.4 billion dollars in commercial and industrial loans, (2) of 129 million in consumer loans, (3) and of 114 million in real estate loans. Loans to dealers and brokers in securities were reduced for the second consecutive year. The 1957 decline amounted to 444 million dollars (19.2 per cent).

The continuing demand for loans together with the relative scarcity of funds available for them brought a rise in the loan rates. New York City banks raised their rates to "prime" borrowers in August 1956 from 3¾ to 4 per cent and in August 1957 from 4 to 4½ per cent (the high-



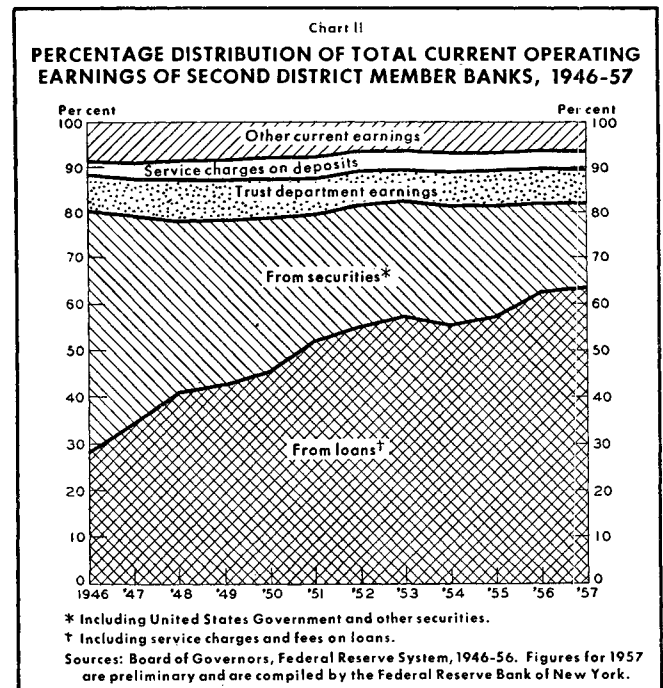
est since 1930). Consequently, the City banks' effective rate of return on loans moved upward from 4.06 per cent in 1956 to 4.45 per cent in 1957. Other banks in the District showed effective rates of 5.56 per cent in 1957, up from 5.32 per cent in 1956. Reserve city and country banks do not have as many "prime" borrowers as City banks, and loan rates for these banks, therefore, tend to be above the ones charged by the City banks.

Relative to total earnings, income from loans (including interest, discount, and service charges) of all groups of Second District banks has attained new highs in almost every year since the Second World War. Chart II indicates that income from loans as a percentage of total current operating earnings reached 63.6 per cent for 1957 in contrast to 45.4 per cent for 1950 and 28.7 per cent for 1946. The chart also reveals that for the same period the relative contribution of income from securities (interest on United States Government securities plus interest and dividends on all other securities) to total current operating earnings has declined from a high of 51.5 per cent for 1946 to 18.4 for 1957.

Contrary to 1956, income from securities in absolute terms rose 5.9 per cent in 1957. The earnings of 313.0 million dollars from this source were exceeded only in 1946 and 1955. Contributing to the improvement in earnings on investments was a reduction in the rate of security liquidation. In addition, the higher yields on short-term and long-term issues, available throughout most of 1957, offered the banks an opportunity to sell securities in order to establish tax losses and then to transfer the funds into

issues offering a higher coupon rate, and to replace maturing obligations with issues bearing a higher interest rate. The ratio of total income from securities to the average amount of securities held by the member banks of the Second District rose from 2.25 per cent in 1956 to 2.46 per cent in 1957. The City banks raised their rate of return from 2.22 per cent to 2.44 per cent and the reserve city and country banks raised theirs from 2.29 per cent to 2.50 per cent.

Income from trust departments increased last year for both the City and the combined reserve city and country banks, but it represented a much more significant source of earnings to the former than to the latter. In 1957 the City banks received about 10 per cent of their total current earnings from their trust departments, compared with only 2.6 per cent for the balance of the banks in the District. On the other hand, income from service charges on deposit accounts, which increased 10.2 per cent for all banks in the District combined, remained a relatively more important source of earnings for reserve city and country banks than for the central reserve city banks. Last year, service charges on deposit accounts at the reserve city and country banks increased by 14.4 per cent to an amount equal to 7.4 per cent of total current income. The City banks, showed a gain of 4.1 per cent in income from this source, providing 2.3 per cent of total earnings. Chart II indicates that although income from service charges on deposit accounts has increased in absolute terms since 1946, relative to other sources of earnings, no significant gain has occurred.



OPERATING EXPENSES

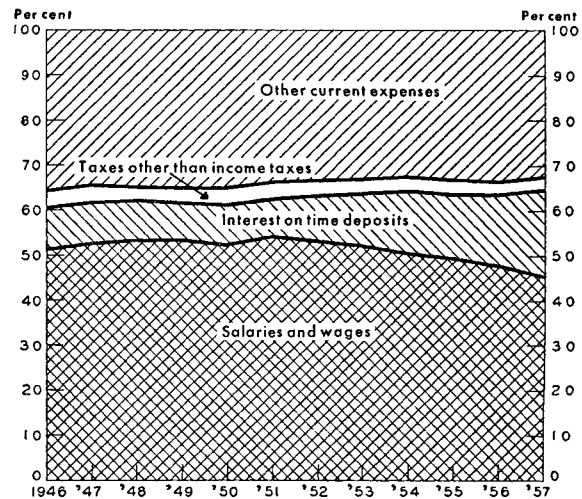
Total current operating expenses reached a new high of 999.2 million dollars for all member banks in the Second District during 1957. While in the last six years the annual increases in total earnings have exceeded those in total operating expenses, only a slight difference existed between the percentage increases in operating expenses and current operating earnings. Between 1951 and 1957 earnings increased by 88.2 per cent and expenses by 85.1 per cent. The percentage increase in operating expenses from 1956 to 1957 was higher for the reserve city and country banks (15.3 per cent) than for the City banks (10.7 per cent).

Salaries of officers and wages of employees last year were up 5.4 per cent and 8.2 per cent, respectively, in the District as a whole. The increases represent in part an expansion of staffs and in part pay increases. Total employment of officers and employees at District banks was up 1.9 and 3.5 per cent, respectively. The percentage gain in officers' salaries was uniform for all groups of banks in the District, but the percentage increase in wage payments was slightly higher at the reserve city and country banks than at the City banks. In order to attract and hold present personnel, banks outside the City have increased their wage scales at a faster rate in recent years. Higher wage scales continue to be paid, however, at City banks.

Salaries and wages remain the most important expense items of member banks, but relative to total current operating expenses both have declined in significance, salaries of officers somewhat more than salaries and wages of employees. In 1951 these payments accounted for a high of 54.2 per cent of total operating expenses and in 1957 for 45.8 per cent. The percentage drop was only slightly higher for the City banks than for other banks in the District.

Interest paid on time deposits, on the other hand, has become a more important expense item, according to Chart III. In 1957, interest on time deposits was up 36.2 per cent and accounted for 19.1 per cent of total current operating expenses in contrast to 8.5 per cent for 1951. Inasmuch as time deposits are a higher proportion of total deposits for banks outside the City and rates at these banks until recently generally were lower than they were in New York City, the percentage increase in interest expenses on time deposits has been more pronounced for this group of banks. Encouraged by the demand for loans and consequently their need for funds, as well as a change in Regulation Q which was announced in December 1956 and which permitted commercial banks to offer an interest rate as high as 3 per cent on savings accounts, many commercial banks became more active solicitors for time deposits. During 1957 the City banks added nearly 8.1 per

Chart III
PERCENTAGE DISTRIBUTION OF TOTAL CURRENT OPERATING EXPENSES OF SECOND DISTRICT MEMBER BANKS, 1946-57



Sources: Board of Governors, Federal Reserve System, 1946-56. Figures for 1957 are preliminary and are compiled by the Federal Reserve Bank of New York.

cent to their total average time deposits and other banks in the District nearly 8.4 per cent. For all member banks in the District combined, interest paid on time deposits as a percentage of the total average time deposits rose from 1.73 per cent in 1956 to 2.17 per cent in 1957. The effective rate paid by both the City banks and banks elsewhere last year was similar. Prior to 1956 City banks paid a lower effective rate on time deposits than other banks.

Because of the relative scarcity of reserves during most of 1957, member banks continued to buy funds in the "Federal funds" market and to borrow from the Federal Reserve Bank of New York. Also, the "Federal funds" rate and the discount rate were higher in 1957 than in 1956. Both factors were reflected in the figures on expenses incurred for interest and discount on borrowed money. For all member banks in the District these amounted to 16.9 million dollars, 9 per cent above 1956. Borrowings of City banks accounted for 87.6 per cent of the total. For the City institutions, interest and discount paid on borrowed money last year amounted to 2.5 per cent of total operating expenses, compared with 1/2 of 1 per cent for all other banks in the District.

NONRECURRING ITEMS

Second District member banks decreased their net charge-offs on loans from 34.7 million dollars in 1956 to 14.3 million in 1957. While recoveries amounted to 1.7 million dollars more in 1957 than in 1956, losses and charge-offs on loans were 18.7 million dollars less in 1957. With a smaller loan increase in 1957 than in 1956, mem-

ber banks added a net of only 59.3 million dollars to their loan valuation reserves last year, compared with 96.3 million in 1956. The City banks showed proportionately larger declines in both the net additions to loan valuation reserves and net charge-offs than reserve city and country banks.

All member banks in the Second District had net security losses of 81.5 million dollars in 1957, compared with 72.1 million dollars in 1956. These losses represent new highs for the post-World War II period. Net security losses were up 16.2 per cent in the City and 4.2 per cent elsewhere. These losses reflect in part the liquidation of securities, primarily by City banks, to provide loan funds. But since average investment portfolios declined only slightly in amount in 1957, the security losses are also an indication of securities switches to establish tax losses.

TAXES, DIVIDENDS, AND RETAINED EARNINGS

District banks increased their net profits after taxes, but before dividends, by 56.6 million dollars, a gain of 22.4 per cent over 1956. A larger gain in net profits was achieved by the City banks (23.6 per cent) than by other banks in the District (18.9 per cent). Income taxes paid

by all member banks in the District were up by 30.6 per cent. Since 1952, income taxes on the earnings of member banks in the Second District have increased by 50.4 per cent, while net profits after taxes have improved by 35.3 per cent.

Cash dividends paid by the City banks increased by nearly 14 per cent during 1957 and those by other District banks by 22 per cent. The reserve city and country banks paid out 55.4 per cent of earnings to their stockholders, compared with 54.0 per cent in 1956. City banks were somewhat more conservative, reducing their percentage cash payout from 70.5 per cent to 64.9. The ratio of net profits to average capital accounts increased from 6.7 to 7.7 per cent for the District. The rate of return on capital for District member banks, however, continued to lag behind the rate for all member banks. Although the rate of increase was smaller, the ratio of profits to capital for all member institutions on the average rose from 7.7 to 8.3 per cent. Within the District the ratio of net profits to average total capital accounts improved more for the City banks than for the others, rising from 6.7 per cent to 7.9 per cent. The gain for reserve city and country banks was from 6.5 per cent in 1956 to 7.3 per cent in 1957.

Earnings and Expenses of Second District Member Banks, Selected Years
(In millions of dollars)

Item	Central reserve New York City banks				Reserve city and country banks			
	1945	1950	1956	1957	1945	1950	1956	1957
Number of banks.....	37	23	18	18	777	728	569	542
Earnings:								
On United States Government securities.....	222.1	144.6	132.9	137.0	81.5	72.9	87.0	94.8
On other securities.....	24.2	31.3	46.9	46.9	10.3	16.0	28.9	34.3
On loans (including service charges and fees on loans).....	105.6	215.1	633.3	727.9	45.2	142.2	319.7	361.4
Service charges on deposit accounts.....	7.5	18.3	24.6	25.6	9.0	19.6	37.0	42.2
Trust department earnings.....	40.7	57.5	104.9	114.6	5.3	8.5	12.9	15.1
Other current earnings.....	32.1	47.4	71.5	85.2	12.9	16.3	23.3	24.3
Total current operating earnings.....	432.2	512.2	1,014.1	1,137.2	164.2	275.5	508.8	572.1
Expenses:								
Salaries and wages—officers and employees.....	116.8	169.7	274.5	293.7	46.4	87.4	152.0	164.6
Interest on time deposits (including savings deposits).....	5.6	9.7	59.1	79.7	23.8	31.7	81.1	111.2
Interest and discount on borrowed money.....	1.0	1.9	13.3	14.8	0.2	0.3	2.2	2.1
Taxes other than on net income.....	10.2	11.8	14.2	15.6	6.0	8.3	12.0	13.4
Recurring depreciation on banking house, furniture, and fixtures.....	4.2	3.5	10.0	11.5	3.7	5.6	11.2	13.0
Other current operating expenses.....	78.6	101.3	164.9	178.3	32.3	56.3	93.2	101.3
Total current expenses.....	216.4	297.9	536.0	593.6	112.4	189.6	351.7	405.6
Net current operating earnings before income taxes.....	215.8	214.3	478.1	543.6	51.8	85.9	157.1	166.5
Net recoveries (+) or charge-offs (-) on loans.....	+ 1.3*	- 2.7	- 29.0	- 8.1	+ 1.2*	- 1.2	- 5.7	- 6.2
Securities profits and recoveries (+) or charge-offs (-).....	+ 100.2†	+ 13.5	- 53.0	- 61.6	+ 26.1†	+ 6.8	- 19.1	- 19.9
All other recoveries (+) or charge-offs (-), net.....	- 12.4	- 3.8	+ 17.1	+ 1.3	- 2.7	- 0.6	- 1.7	+ 3.2
Net additions to (-) or deductions from (+) valuation reserves for:								
Loan losses.....	—	- 14.2	- 65.3	- 36.2	—	- 12.1	- 31.0	- 23.1
Securities losses.....	—	+ 6.9	- 2.2	+ 3.4	—	+ 0.2	+ 1.2	- 0.4
Net profits before income taxes.....	304.9	214.0	345.7	442.4	76.4	79.0	100.8	120.1
Taxes on net income.....	90.7	68.6	156.7	208.8	16.0	23.2	37.3	44.6
Net profits after income taxes.....	214.2	145.4	189.0	233.6	60.4	55.8	63.5	75.5
Cash dividends paid or declared.....	73.0	89.4	133.2	151.7	13.9	20.2	34.3	41.8
Retained earnings.....	141.2	56.0	55.8	81.9	46.5	35.6	29.2	33.7

* Includes transfers to or from valuation reserves for loan losses.

† Includes transfers to or from valuation reserves for losses on securities.

Sources: Board of Governors of the Federal Reserve System, 1945-56; figures for 1957 are preliminary and are compiled by the Federal Reserve Bank of New York.