

FEDERAL RESERVE BANK OF NEW YORK



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Contents

The Business Situation	106
Money Market in July	110
International Monetary Developments ...	114
Sterling: A Year of Recovery	115

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The Business Situation

It seems probable that business activity passed a low point in April and has recovered moderately since that time. Production has advanced along a broad front, construction work has increased, and total sales and orders have continued to improve. Employment has expanded, hours of work have lengthened sharply, and personal income is probably at an all-time high. Even though the number of students and graduates entering the job market in May and June was close to the record totals of 1956 and 1957, unemployment increased only about seasonally to 5.4 million, when just a few weeks earlier it had been feared the total might reach 6 million. Unemployment as a proportion of the labor force dropped from 7.2 per cent in May (seasonally adjusted) to 6.8 per cent in June (see Chart I).

In July, moreover, although the data are still fragmentary, business apparently improved in many lines. Steel production declined only about seasonally, and new orders reportedly held up better than expected. Petroleum output increased and is scheduled to gain further in August, while demand for both natural and synthetic textiles is reported to have firmed somewhat. Construction activity appears to have started on a strong summer surge; housing starts increased in June for the fourth consecutive month, and, beginning with May, contracts for public construction have been awarded at record rates. Personal income was bolstered by the Federal Civil Service pay increases and retroactive payments, and department store sales increased sharply; auto sales apparently showed only the usual seasonal drop. On the other hand, a number of reports of unusually prolonged vacation shutdowns suggest a good many industries must still be trying to reduce excessive inventories. Moreover, while total new orders received by equipment manufacturers remained steady or rose slightly in the second quarter, probably reflecting the sharp increase in military orders, backlogs of orders in the capital goods industries are apparently still on the decline.

An added note of uncertainty has been injected into the business picture by the Middle East crisis. It is possible that the crisis may lead to higher military spending and to some precautionary inventory buying both here and abroad—even though, as in the case of the Suez crisis, these increases in demand might be transitory. Of course, the fear of war and shortages has strengthened the upward pressures on raw-material prices that already appeared to be emerging even before the crisis broke out. Increases have just been announced for steel and alumi-

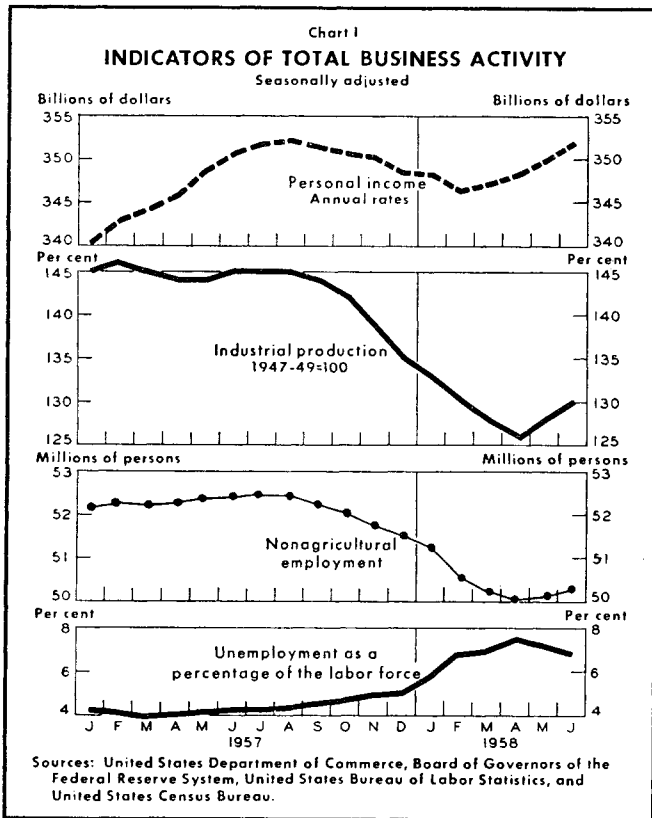
num prices, and there also have been more frequent reports of price increases, actual or under consideration, on items that are primarily consumer goods, such as autos, apparel, tires, and gasoline. In the few weeks since mid-June, the industrial wholesale price index has regained almost all of its earlier small decline (about $\frac{2}{3}$ of 1 per cent) from the January 1958 record.

While there have been further increases in wage rates, the price pressures may be eased to some extent by increases in productivity, if output continues to rise and thus moves closer to the optimum rates for which plants and equipment have been designed. In addition, competitive restraints resulting from ample capacity and the large inventories still on hand in some lines also may help to keep prices from rising. On the other hand, recovery is often associated with a climate in which resistance to higher prices and to wage demands tends to weaken.

If April does turn out to have marked the recession low and business trends continue upward, the 1957-58 business contraction will have been not only the sharpest and most severe of the postwar period but also the shortest. It is prudent to recall, however, that during the earlier postwar recessions of 1948-49 and 1953-54, the initial strengthening in business activity was followed by a mild setback, so that in both these instances the economy may be described as having "bumped along the bottom" for several months before embarking on a sustained upturn. While the recent gains in output and employment have been larger than the initial improvements in 1954, they are no greater than in 1949. However, the advance in output and employment has been broader than in either 1954 or 1949, in terms of the number of industries participating. Between April and June, for example, almost every major category of the industrial production index showed a gain of at least 2 points, and employment also increased significantly in such nonmanufacturing industries as construction and retail trade.

SOURCES OF THE IMPROVEMENT

The recent improvement has come somewhat sooner and more vigorously than many observers had perhaps anticipated. Taking into account the more drastic cut-backs in business investment, both in plant and equipment and inventories, the abnormally sharp drop in consumer purchases of automobiles, and the more rapid spread of unemployment, the recession appeared to many to have gathered considerably more momentum than the earlier



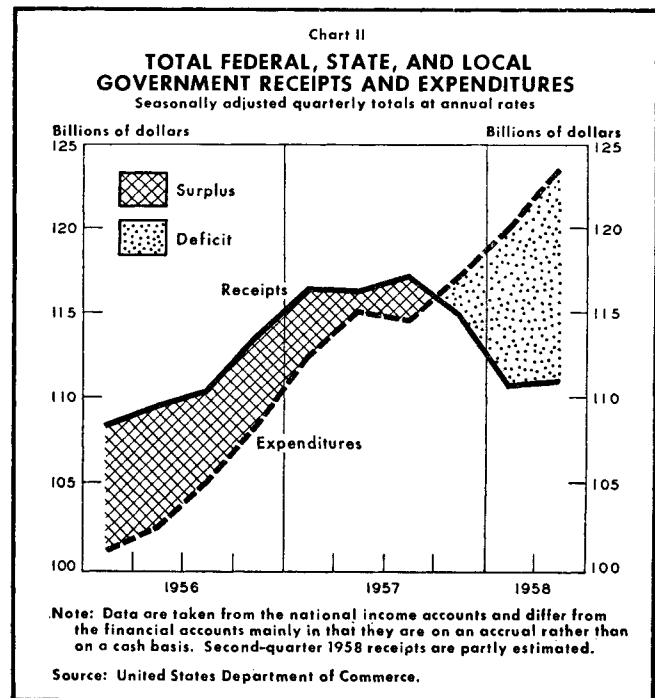
postwar recessions. Nevertheless, the contraction—if it is indeed over—has, as already noted, been even briefer than its two postwar predecessors.

While it is too early for a definitive analysis of this favorable turn of events, it seems clear that much of the explanation is to be found in the massive support provided by the government sector, which has been of considerably greater importance than has been generally realized. Indeed, the swing from surplus to deficit appears to have been faster and larger than during the recession periods of either 1948-49 or 1953-54—despite the tax cuts which reduced revenues in each of these periods. Partly as a result of the operation of the “built-in stabilizers”, partly as a result of anti-recession legislation, and partly as a result of other measures not primarily related to the recession, total government spending (Federal, State, and local) rose from a seasonally adjusted annual rate of \$114½ billion in the third quarter of 1957 to \$123½ billion in the second quarter of 1958 (see Chart II), and seems likely to increase considerably further. Over the same interval, receipts fell from over \$117 billion to an estimated \$111 billion. Thus, within three quarters, the government sector turned from a net “saver”, with a sur-

plus (at a seasonally adjusted annual rate) of nearly \$3 billion, to a net spender with a deficit of \$12½ billion.

A significant part of the growth in net government outlays reflects higher spending by State and local governments. Although the recession has tended to pinch municipal revenues, the reductions in receipts have apparently been offset in most cases by higher tax rates, increased Federal grants under the highway and other programs, and by the greater volume of funds and more favorable terms available for new borrowing. Between the first and third quarters of 1957, State and local purchases had shown virtually no increase. Since then, however, such spending has been advancing rapidly; through the second quarter of 1958, the gain amounted to about 9 per cent or, in terms of seasonally adjusted annual rates, to over \$3 billion.

Federal purchases and payrolls, on the other hand, did not turn upward until quite recently. (In 1953-54, it may be recalled, they declined throughout the recession.) But while actual outlays were roughly stable, orders for heavy military equipment were being stepped up sharply, from a curtailed annual rate of \$8½ billion in the third quarter last year to more than \$20 billion (if schedules have been met) in the second quarter of 1958. For the first half of 1958, these orders for military equipment amounted to some 15 per cent of all orders received by all manufacturers of durable goods, and the subcontracts and the



purchases of materials and parts by the companies that received military orders may well have accounted for a further significant fraction of the over-all order volume. Activity in the military equipment industries, which had been declining earlier, stabilized soon after the increase in orders began and recently may have started to expand.

Above and beyond the increased purchases, payrolls, and orders, government outlays under various benefit programs also showed a much sharper increase than in the earlier postwar recessions. Such "transfer" payments jumped by \$4½ billion (annual rate), or more than 20 per cent, between September and April. About \$2½ billion of the rise occurred in unemployment insurance payments, and about \$1½ billion in public retirement benefits, as many older persons took advantage of the liberalized provisions enacted in 1956 for women and the self-employed. The rise in these transfer payments offset fully half the contraction in wage and salary earnings between last August and the April low, and largely explains why the decline in total personal income during the recession was so moderate. Other important factors which contributed to the maintenance of personal income were the sharp expansion in farm proprietors' income and the well-sustained level of dividends; in the first quarter of 1958, dividend payments equaled the year-earlier total although after-tax corporate profits had declined by about one third. At its recession low in February, personal income had declined only 1½ per cent from its all-time peak, and this loss had been almost completely recovered by June.

The steadiness of personal income in turn helps to explain why, as in the previous recessions, total consumer spending held up so well. Despite the pronounced weakness in the demand for consumer durables and the contraction in instalment credit, aggregate consumer buying dropped less than 1 per cent between the third quarter of 1957 and the opening quarter of 1958, and most of this drop was made up in the second quarter. Notwithstanding the growth in unemployment and the shortening of work-weeks, which may have affected at one time or another as many as one out of every four families, consumers were apparently determined to maintain prosperity standards of living wherever possible. Outlays on food and services increased in line with the prices of such items, and generally speaking there did not seem to be any widespread shift in consumer demands toward goods of lower quality.

This summer, a variety of special developments are bolstering incomes. By the last week in July, over half a million persons had filed for benefits under the new legislation that authorizes the continuation of pay-

ments to persons who have exhausted their unemployment insurance credits. The Federal civilian and military pay increases have added about \$1½ billion to the annual rate of personal income, and widespread pay increases are occurring in industry under long-term contracts and cost-of-living escalator clauses, as well as under newly negotiated contracts. The payment of the retroactive portions of the Federal increases is providing a further very large, although temporary, boost. Meanwhile, the monthly rate of instalment repayments has been drifting lower, as people complete repayment on old obligations and take on fewer new ones. Finally, the rise in food prices was halted in May and June, and these prices may well turn down at least seasonally later in the year. These developments suggest that many consumers may soon find their discretionary incomes substantially enlarged, quite apart from the growth in such incomes that would result if economic recovery were to gather strength and many of the unemployed again found jobs.

However, the fact that spending on goods and services that people regard as essential remained strong during the recession, when incomes were declining, does not necessarily imply that spending on less urgent items will rise sharply when incomes expand. The latest survey of consumer attitudes by the Michigan Survey Research Center does show that people generally feel more optimistic about the business outlook than they did last fall, and that more of them think the present is a good time to buy. But the Survey also notes a slight decline in buying plans for major durable goods, and reports a substantial increase in the number of respondents who expect prices to go down over the coming twelve months. On the whole, therefore, the Survey suggests that, although the public may be in a better frame of mind to make discretionary purchases, it may require vigorous selling to convert this attitude into actual sales.

PROGRESS IN INVENTORY LIQUIDATION

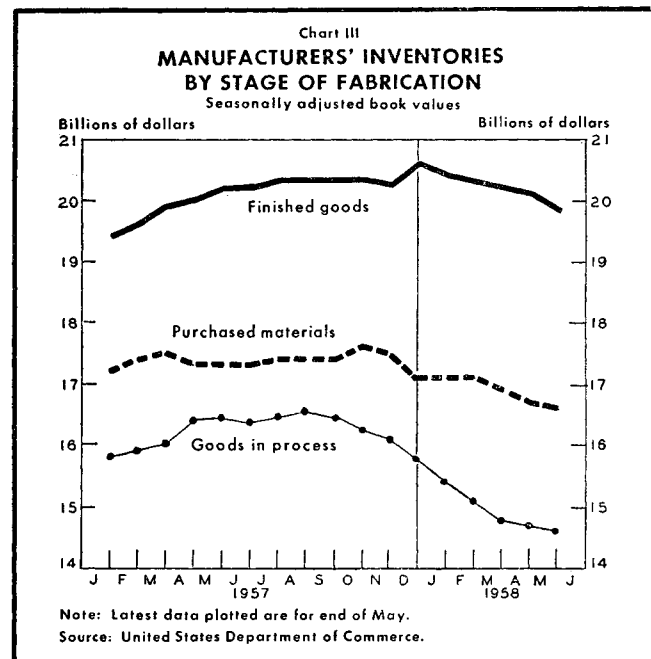
The current pickup in over-all business activity has come at a time when business capital outlays and consumer purchases of durable goods appear to be no more than leveling off after their sharp declines, and are giving little indication of any sizable and immediate recovery. So far, home building and government spending appear to be the only sectors in which final demand in real terms has increased significantly. But the key fact is that even the stabilization of final demand is of vital importance for the behavior of inventories; so long as final demand holds steady, inventory liquidation sooner or later must slow down and eventually stop.

Indeed, it seems likely that the recent gains in manufacturing employment and hours rest in some measure on a lessening in the rate at which business firms have been liquidating their inventories. The Council of Economic Advisers' preliminary estimate of inventory change for the second quarter shows the rate of liquidation as unchanged from the record first-quarter rate of \$9.5 billion annually. However, monthly data covering the book value of inventories show some slackening of liquidation from month to month within the second quarter. The tendency toward a slower rate of liquidation was, however, confined to retail and wholesale trade. Stocks of new automobiles were still being worked down into line with the low rate of sales, but other durable goods dealers and department stores actually increased their inventories somewhat, following the sizable reductions effected since last fall.

At the manufacturers' level, where most of the overhang of stocks has been concentrated, liquidation continued unabated during the second quarter. Sales, however, began to improve, and inventory/sales ratios declined appreciably. A further encouraging feature of the second-quarter inventory liquidation on the part of manufacturers was the shift toward a more rapid drop in finished-goods stocks (see Chart III). Previously, the decline in factory inventories had been concentrated mainly in stocks of purchased materials and goods-in-process, which manufacturers can reduce relatively quickly by cutting back production and purchasing. In May and June, by contrast, half of the drop in manufacturers' stocks occurred in finished goods. Such stocks are more difficult to control and usually do not decline appreciably until the later stages of a business contraction when sales to customers stabilize or turn up.

The mere cessation of inventory liquidation, it may be very roughly estimated, would permit an increase of upward of 5 per cent in the volume of industrial output. This would, of course, be reflected in sizable gains in employment and incomes. In some industries, inventories are reported to have been reduced to near-minimum levels, and the improvement in the business situation, the firming of prices, and the aggravation of international tensions thus come at a time when inventory policies are perhaps already ripe for reversal. Of course, manufacturers' inventories are still very high relative to sales, but experience has shown that inventory/sales ratios can improve very rapidly once sales begin to show significant gains.

On the other hand, the slowing-down in over-all inventory liquidation could turn out to be rather gradual and drawn out. Temporary factors may have played an important role in keeping the rate of liquidation in recent months



from becoming even more rapid. Some part—opinions vary as to how much—of the increase in inventory demand for steel and other metals undoubtedly represented hedging against the widely anticipated price increases. Furthermore, the restocking by appliance retailers, which in turn was probably responsible for the reported increase in production by appliance manufacturers, could be quickly reversed if sales fail to improve. Finally, to the extent inventory purchases are increasing because of the international situation and the upward pressure on prices, they could rapidly fall back should the international crisis subside.

More generally, inventory purchasing is governed not only by current sales, but also by businessmen's expectations with regard to future demand, availability of supplies, and prices. Sales have increased only modestly so far, but the pickup follows a period of sharp decline, and may therefore give rise to expectations of more substantial gains to come, particularly in the area of durable consumer goods. Similarly, supplies of virtually all types of goods have remained ample but, if businessmen anticipate sharply larger demand or fear shortages and price increases because of the international situation, they may choose to step up inventory purchasing nonetheless. Depending on how businessmen evaluate and take action in response to these various contingencies, the reduction in the rate of inventory liquidation may be fast or slow. The vigor of the business recovery may be determined in large measure by the speed with which strength develops in this most volatile sector of demand.

Money Market In July

July was a month of turbulence in the Government securities market and of difficult decisions in the area of monetary policy. Although reserve balances were in ample supply and the money market generally easy, serious strains developed in the Government securities market. To a considerable extent, the imbalance in the market arose out of the large volume of securities acquired during the June and earlier financings by temporary holders, some outright and some on unduly thin margins, in the hope of speculative gains derived from further credit-easing moves by the Federal Reserve System. In July, however, the continued improvement in business news, the growing rumors that a consequent hardening of Federal Reserve credit policy might be in prospect, fiscal developments, and, finally, the Middle East crisis combined to bring about a sharp reversal of anticipations. Institutional investors joined speculative holders in attempting to reduce their portfolios of Governments, and the pressures, which had been concentrated on the recently issued securities, spread throughout the list. The resultant declining trend in Government securities prices became accentuated by forced selling brought about by margin calls by lenders other than commercial banks who had financed speculative securities holdings on thin margins.

The decline in prices of long-term Treasury securities, which had begun in mid-June, accelerated during the first half of July, although a steadying influence was exerted by the Treasury's announcement on July 9 that it had purchased almost \$600 million of the new 2½ per cent bonds of 1965. The decline in prices halted only briefly, however, and the volume of offerings in the market continued to expand while potential purchasers held back to await developments. On July 18, with offerings rapidly mounting and virtually no buying in the market, it was announced that, "In view of conditions in the United States Government securities market, the Federal Open Market Committee has instructed the Manager of the Open Market Account to purchase Government securities in addition to short-term Government securities".

The announcement had an immediate effect upon expectations, and bond prices recovered somewhat. Although subsequent modest System purchases in the intermediate and long-term area tended to stabilize prices, the market atmosphere remained heavy and investor reaction to the Treasury's \$16.3 billion August 1 refunding operation was not favorable. Despite Federal Reserve System purchases of "rights" to the exchange and of more than \$1 billion "when-issued" securities during the July 21-23 subscription period, the attrition on the

refunding amounted to about \$2.8 billion. Simultaneously with the disclosure on July 25 of the results of the exchange operation, the Treasury announced a \$3.5 billion cash offering of tax anticipation certificates for July 29. The issue was oversubscribed, although by a considerably smaller margin than usual. The Treasury bond market again was subject to selling pressure late in the month, but prices turned around and were moving upward as the month drew to a close.

Federal Reserve purchases of Government securities provided sufficient funds to the banking system over the month approximately to offset the drains of reserves brought about by market influences. Thus, a general atmosphere of ease continued to prevail in the money market. Except for some temporary firmness on a few days early in the month, the effective rate for Federal funds was below 1 per cent, occasionally falling to ¼ or even ⅛ per cent. Treasury bill yields edged up intermittently during the first half of the month and moved within a fairly narrow range thereafter; at the end of the month the longest Treasury bill was bid at 0.91 per cent, as against the month's peak of slightly over 1 per cent and ¾ per cent on June 30.

MEMBER BANK RESERVE POSITIONS

Free reserves of member banks averaged \$575 million during the five statement weeks ended July 30, about \$90 million above the average for June. Average member bank borrowing from the Reserve Banks, at \$110 million, was somewhat lower than in June, while excess reserves edged up on average.

A decrease in average required reserves in each of the five July statement weeks added \$460 million to member bank excess reserves, as bank credit and deposits fell back following the sharp increases in June. Other operating transactions as a whole drained reserves in all but the fourth July statement week, for a net loss of reserves of \$557 million over the month. Of this absorption of reserves \$142 million was attributable to gold and foreign account transactions, considerably less than the reserve losses stemming from this source in recent months. The reduced outflow of gold reflected in some degree a seasonal shift in the balance of payments of some countries that had been adding rapidly to their gold and dollar reserves earlier this year.

Early in July, System open market purchases more than offset the large drain on reserves stemming from currency outflows, float movements, and other market factors. Later in the month, however, a net decline in System holdings

Table I
Changes in Factors Tending to Increase or Decrease Member
Bank Reserves, July 1958
(In millions of dollars; (+) denotes increase,
(—) decrease in excess reserves)

Factor	Daily averages—week ended					Net changes
	July 2	July 9	July 16	July 23	July 30	
Operating transactions						
Treasury operations*	+ 4	— 34	— 17	+ 27	— 80	— 100
Federal Reserve float	— 209	+ 132	+ 32	+ 66	— 222	— 201
Currency in circulation	— 188	— 221	+ 9	+ 158	+ 131	— 111
Gold and foreign account	— 13	— 40	— 99	+ 45	— 35	— 142
Other deposits, etc.	— 137	+ 36	+ 8	+ 35	+ 57	— 1
Total	— 543	— 127	— 68	+ 330	— 149	— 557
Direct Federal Reserve credit transactions						
Government securities:						
Direct market purchases or sales	+ 528	+ 37	— 194	— 105	— 122	+ 144
Held under repurchase agreements	— 108	— 3	—	—	—	— 111
Loans, discounts, and advances:						
Member bank borrowings	— 2	+ 46	— 28	— 30	+ 23	+ 9
Other	—	—	—	—	—	—
Bankers' acceptances:						
Bought outright	— 1	— 1	— 1	— 1	— 3	— 7
Under repurchase agreements	+ 2	— 2	—	—	—	—
Total	+ 419	+ 77	— 223	— 136	— 101	+ 36
Total reserves	— 124	— 50	— 291	+ 194	— 250	— 521
Effect of change in required reserves †	+ 108	+ 122	+ 98	+ 32	+ 100	+ 460
Excess reserves †	— 16	+ 72	— 193	+ 226	— 150	— 61
Daily average level of member bank:						
Borrowings from Reserve Banks	97	143	115	85	108	110 †
Excess reserves †	683	755	562	788	638	685 †

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 July 30.

of Government securities served to neutralize the release of reserves by various market forces, as well as to reduce the forthcoming reserve effects of the System Account's large-scale purchases of the new 1½ per cent Treasury certificates on a "when-issued" basis. These purchases did not affect member bank reserve positions in July since payment was not made until August 1. Total System holdings of Treasury securities declined by \$40 million between June 25 and July 30, as increases of \$10 million in notes and \$165 million in bonds (of which \$110 million were bonds maturing within five years) were more than offset by a decline of \$215 million in holdings of Treasury bills.

GOVERNMENT SECURITIES MARKET

During the first half of July prices of Treasury notes and bonds declined with only a few brief rallies. Sales of the new 2½ per cent and 3¼ per cent bonds issued in June, and to a lesser extent other recent issues, many of which were held on thin margins, continued to be pressed on an unreceptive market. The weakness of investor demand stemmed in part from the continuing signs of improvement in the business picture and a

revival of fears of inflation, and the consequent press reports conjecturing a change in credit policy; the crisis in the Middle East also served to cut buying interest further. On July 9, the Treasury announced that in the preceding few weeks it had purchased \$589.5 million of the new 2½ per cent bonds of 1965, and that \$456 million of the \$7.4 billion issue would be retired. The excessive market supply following the heavy subscriptions for this issue in the June refunding had been a major factor in depressing the entire Government securities market. The Treasury's statement regarding its purchases served to strengthen the market basically despite adverse criticism in some quarters.

The Treasury's announcement on July 17 that a one-year certificate would be the only issue offered in the August 1 refunding was accompanied by an announcement to the effect that cash borrowing to take place shortly after the refunding would be carried out through a security maturing in one year or less. But these announcements led to only a very brief rally in bond prices, and selling pressures resumed by midmorning of July 18. Offerings from speculative sources were augmented by offerings from institutional investors, and the pressures fanned out from recently issued bonds to the entire range of Government securities. In the midafternoon of July 18, as bond prices were piercing earlier 1958 lows and there was a virtual absence of bids in the market, the Federal Open Market Committee authorized purchases by the System Account of Government securities in addition to short-term issues. Prices immediately recovered, and after rising further the next trading day, held more or less steady for several days, in part as a result of Federal Reserve purchases.

The subscription books for the Treasury's refunding offer of a one-year 1½ per cent certificate dated August 1 were open on July 21 through July 23. Rights to the exchange included \$11.5 billion of 4 per cent certificates maturing August 1 and \$3.8 billion of 2¼ per cent bonds plus about \$900 million of 2¾ per cent bonds called for redemption on September 15. Prior to the refunding, about \$9.1 billion of the \$16.3 billion maturing and called securities was held outside the Federal Reserve System and Government Investment Accounts. The exchange offering met with an unenthusiastic reception and failed to improve the heavy atmosphere in the market. Despite Federal Reserve purchases of "rights" and of \$1,090 million of the new certificates on a "when-issued" basis during the subscription period, exchanges totaled only some \$13.5 billion; this left a total of \$2,770 million to be redeemed for cash, \$890 million of the matured certificates on August 1 and \$1,880 million of the called

bonds on September 15. The "when-issued" certificate declined below par after the subscription books closed, and was bid at 99.31 at the end of July.

Late in the month, prices of Treasury notes and bonds moved downward again, but as the month ended the market strengthened with the return of some investor buying interest. Nevertheless, over the month as a whole, Treasury issues maturing before 1962 lost as much as $2\frac{5}{32}$ points, while those in the 1962-72 range lost up to $2\frac{3}{32}$ points. Longer term bonds closed 2 to $4\frac{18}{32}$ points down for the month. Long-term Treasury yields thus climbed to 3.38 per cent from 3.26 per cent at the end of June and the recent low of 3.07 per cent at the end of April; this compares with the peak of 3.76 per cent reached last October. (See chart.)

On July 29 the Treasury offered for cash \$3.5 billion of $1\frac{1}{2}$ per cent tax anticipation certificates, to be dated August 6, 1958 and to mature March 24, 1959. They will be accepted at par plus accrued interest in payment of income and profits taxes due on March 15, 1959. Commercial banks were permitted to pay for the new certificates by credit to Treasury Tax and Loan Accounts. While the interest in this issue was confined mainly to the larger banks in the country, subscriptions to the offering, the books for which were open only on July 29, totaled \$5,960 million. Allotments amounted to 59 per cent for subscriptions over \$100,000, with subscriptions of \$100,000 or less allotted in full. On July 31 the new

certificates were quoted at 99.30 in "when-issued" trading.

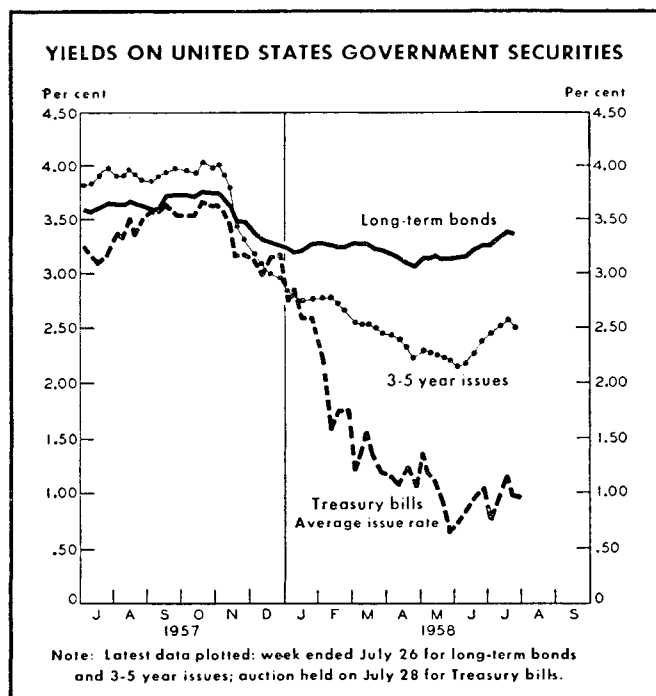
Treasury bill rates during the first half of July resumed the rise begun in June, partly reflecting light private demand and partly temporary reserve pressures on the central reserve city banks. Rates declined irregularly later in the month, as an easier tone returned to the money market and investor demand revived. The average issuing rate established in the weekly Treasury bill auction advanced from 0.768 per cent on June 30 to 0.934 per cent on July 7, and to 1.137 per cent the following week, a two months' high. In the last two auctions of the month the average issuing rates receded to 0.988 per cent and to 0.984 per cent.

OTHER SECURITIES MARKETS

The markets for corporate and municipal bonds displayed a somewhat heavy tone during most of July, partly in sympathy with price movements in the Government bond market and partly because of a continued sizable volume of new issues. Price and yield adjustments, however, were mainly confined to new and recent issues rather than seasoned securities, and many attractively priced new issues were favorably received. An estimated \$680 million of corporate bonds for new capital purposes and \$540 million of municipal bonds were publicly marketed in July. The July total of \$1,220 million was substantially above the \$785 million of June flotations and somewhat larger than the \$1 billion offered in July 1957.

In the first part of the month, two corporate offerings were postponed and the size of another was reduced, reportedly due to unsettled market conditions. A number of underwriting syndicates for corporate and municipal issues formed prior to July were terminated with substantial price cuts. Longer maturities of a \$100 million issue of highway revenue bonds offered at the end of May sold as low as $1\frac{3}{4}$ points below the original reoffering price after the syndicate was terminated in mid-July.

On the other hand, most new issues offered in July, reflecting their more attractive terms, met with a favorable investor response. The corporate calendar in July was dominated by a \$300 million Aa-rated industrial flotation offered at midmonth to yield 3.97 per cent. (Similarly rated industrial issues early in April were marketed at reoffering yields ranging from 3.75 to 3.90 per cent.) This issue enjoyed good investor demand, and was about 90 per cent sold out on the day it was offered to the market. One new Aa-rated public utility flotation was marketed at a reoffering yield of 4.10 per cent, a high since March, which compares with a level of almost 5 per cent in early November. Over the month, average yields on seasoned long-term Aaa-rated corporate bonds



(as measured by Moody's Investor Service) advanced to 3.71 per cent from 3.62 per cent.

The large volume of new municipal flotations led to some hesitancy in that sector of the market. Interest in these issues was mixed, with most smaller issues moving slowly. The month's largest municipal issue, a \$100 million State offering on July 23, was very well received at reoffering yields 25 to 35 basis points higher than on a similar issue floated three months earlier. Toward the end of the month the municipal market improved somewhat, partly because of a decline in the volume of new offerings scheduled for the coming weeks. Moody's index of yields on outstanding Aaa-rated municipal issues stood at 2.84 per cent on July 30, compared with 2.78 per cent at the end of June.

In the market for private short-term debt instruments, major finance companies announced a $\frac{1}{4}$ of 1 percentage point reduction, effective on July 24 and 25, in the rates they pay on directly placed paper, bringing the rate on 30 to 89-day finance paper to 1 per cent. This rate cut, the first by a finance company since April 22, reportedly reflected the general lowering of short-term money rates as well as debt repayments by automobile dealers made possible by the recent cutbacks in automobile inventories.

MEMBER BANK CREDIT

Total loans and investments of the weekly reporting member banks declined sharply during the five weeks ended July 23. This was due in part to an "unwinding" of the rapid expansion that occurred in the first three weeks of June, when tax borrowing and large-scale Treasury debt operations caused a temporary bulge in bank credit. The five-week \$2,163 million drop in member bank credit was mainly the result of a \$760 million fall in business loans and a \$1,244 million reduction in securities loans; the cutback in securities loans, which reversed most of the steep rise of the first part of June, was largely concentrated on loans against Government securities. Investments contracted by \$289 million.

The drop in business loans included reductions of \$288 million in loans to metals and metal products firms, \$127 million in loans to public utilities and transportation companies, and \$123 million in loans to food, liquor, and tobacco concerns. In the corresponding five-week period last year, business loans had declined by \$684 million, in large part owing to repayment of borrowing by sales finance companies after the tax date. Thus far this year, business loans of the weekly reporting banks have fallen by \$2.7 billion and total loans by \$2.3 billion; in the same interval last year, business loans had risen by \$674

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 July 23, 1958
	June 25	July 2	July 9	July 16	July 23	
Assets						
Loans and investments:						
Loans:						
Commercial and industrial loans.....	- 23	+ 5	- 250	- 186	- 306	-2,682
Agricultural loans.....	+ 6	+ 10	+ 4	+ 6	+ 12	+ 96
Securities loans.....	- 508	- 299	- 315	- 115	- 7	+ 471
Real estate loans.....	+ 21	- 1	+ 11	+ 41	+ 8	+ 189
All other loans (largely consumer).....	+ 55	+ 12	- 23	+ 7	- 24	- 306
Total loans adjusted*.....	- 451	- 288	- 572	- 245	- 318	-2,280
Investments:						
U. S. Government securities:						
Treasury bills.....	+ 94	- 127	- 201	- 170	- 35	-
Other.....	+ 122	+ 87	- 37	- 13	- 53	+5,643
Total.....	+ 216	- 40	- 238	- 183	- 88	+5,643
Other securities.....	+ 80	- 243	+ 70	+ 59	+ 78	+1,475
Total investments.....	+ 296	- 283	- 168	- 124	- 10	+7,118
Total loans and investments adjusted*.....	- 155	- 571	- 740	- 369	- 328	+4,838
Loans to banks.....	- 181	+ 71	+ 125	- 225	+ 100	+ 788
Loans adjusted* and "other" securities.....	- 371	- 531	- 502	- 186	- 240	- 805
Liabilities						
Demand deposits adjusted.....	-2,168	- 706	+ 284	+ 810	+ 786	- 447
Time deposits except Government.....	+ 192	+ 74	+ 54	- 53	+ 31	+4,023
U. S. Government deposits.....	+2,268	- 925	-1,736	- 610	- 844	+ 728
Interbank demand deposits:						
Domestic.....	- 541	+1,191	+ 62	- 224	- 510	- 916
Foreign.....	- 48	+ 19	- 44	+ 169	- 8	- 46

* 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.

million while total loans had dropped by \$121 million.

The cutback in investments of the reporting banks during the five weeks ended July 23 was the result of a \$439 million decrease in Treasury bill holdings partly offset by a \$106 million rise in holdings of other Government securities. For the year to date, however, investments show an increase of \$7.1 billion, in contrast to a reduction of \$1.5 billion in the comparable period last year. The rise in investments thus far this year reflects increases of about 20 per cent in holdings of both Government and other securities; the reporting banks' portfolios of Government securities were up by \$5.6 billion (or 21.4 per cent), as holdings of notes expanded by \$2,177 million (or 45.6 per cent) and holdings of bonds by \$3,546 million (or 19.7 per cent). Holdings of certificates declined by \$80 million and bill holdings were unchanged. The expansion of investment holdings in the first twenty-nine weeks of 1958 has been substantially larger than the fall in reporting banks' loans, with the result that total loans and investments were up by \$4.8 billion, as against a decline of \$1.4 billion in the comparable 1957 period.

International Monetary Developments

MONETARY TRENDS AND POLICIES

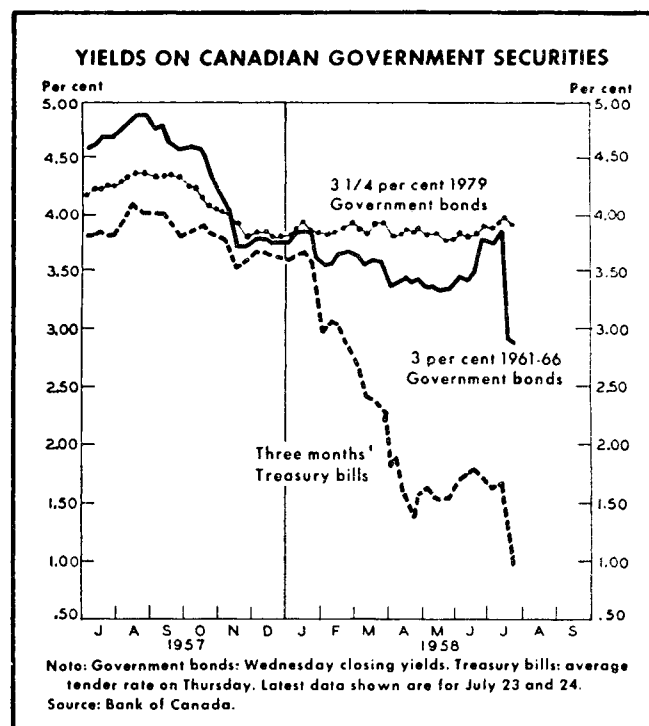
UNITED KINGDOM. The Chancellor of the Exchequer on July 3 announced two changes in the field of British monetary policy. One constitutes a major relaxation of existing restraints on bank lending and on new capital flotations, as discussed on page 119 of this *Review*. The other introduces a new monetary control device in the form of special deposits with the Bank of England that would be required of the banks if a reduction in their liquidity should once more be deemed desirable. Such deposits would carry an interest rate based on the current Treasury bill rate and would not qualify for inclusion in the banks' liquid assets. According to the Governor of the Bank of England, arrangements for such deposits would initially be made with two groups of banks—the London clearing banks and the Scottish banks—but later might be applied more widely. The amount of the calls would be related to the total gross deposits of each group on a specified date, with monthly adjustments to take account of variations in deposits; the ratio of a call to total deposits would not necessarily be the same for each group. The new arrangements, the Governor declared, "would serve to reinforce the existing monetary instruments and would be employed as a general control of credit in the same way . . . as bank rate".

Following announcement of the easing of credit restrictions, the average Treasury bill tender rate, which had stood at 4.29 per cent at the final June tender, fell to 4.17 per cent and at the second July tender dropped further to 4.02 per cent, the lowest since mid-August of last year. Under the impact of the Middle East crisis the rate stiffened again to 4.25, closing at 4.16 on July 25. The yield on 2½ per cent Consols, which had reached a low for the year of 4.85 per cent on July 11, closed at 4.94 per cent on July 31.

CANADA. The Canadian Government on July 14 announced an offer to exchange all outstanding Victory Loan bonds issued during World War II for new, noncallable bonds of longer maturity. The five outstanding series of Victory Loan bonds amount to \$6,416 million, equal to 43 per cent of Canada's national debt and to 61 per cent of outstanding marketable government securities. The maturities of these 3 per cent bonds extend from January 1959 to September 1966; for three of the five issues, aggregating \$4,304 million, the conversion offer anticipates their earliest call dates, which range from February 1959 to September 1961. The new securities offered in

exchange are four issues of 3¼, 7, 14, and 25 years, carrying coupons, respectively, of 3, 3¾, 4¼, and 4½ per cent. When transfers begin on September 1, holders of Victory Loans may exchange them for any of the four new issues offered, provided the maturity of the new issue exceeds that of the converted one by a specified margin; those accepting the conversion offer will receive a cash premium of between \$12.50 and \$25 per \$1,000, depending on the new series selected. The government's immediate cash needs have been covered by a \$400 million 2½ per cent five-month bond issue placed in mid-July with the Bank of Canada and the chartered banks. The short maturity of these obligations was stated to be dictated by the customarily heavy net sales of Canada Savings Bonds to the public in the final quarter of the year.

The Finance Minister had already hinted in mid-June at "new long-term issues whenever . . . opportunities occur", since "to refund maturing issues in the short-term market would only build up greater difficulties for ourselves two or three years hence". At the time of the conversion offer, the Minister declared that the massive refunding operation was aimed chiefly at lengthening the national debt and at reducing the amount of funding that otherwise would be required over the next few years. Success of the con-



version is expected to encourage investors to take renewed interest in all bond markets, including those for provincial and municipal issues.

The initial market reaction to the conversion offer was generally favorable. While prices and yields on longer dated government securities showed but moderate movement, the 3 per cent 1961-66 Victory Loan gained 6 points between July 9 and 16, with the yield declining from 3.83 to 2.91 per cent and falling further to 2.86 on July 23 (see chart). At the short end of the market, the average Treasury bill tender rate fell from 1.66 per cent in early July to 0.97 on July 24, the lowest level since January 1955.

BELGIUM. The National Bank of Belgium lowered its discount rate to $3\frac{3}{4}$ per cent from 4, effective July 3; the rate had previously been reduced by $\frac{1}{4}$ per cent each on June 5 and March 27. The latest reduction reflects mainly the continuing improvement in Belgium's international position (associated with tourist receipts and short-term capital inflows) and the further easing of the money market. Like the earlier discount rate decreases, last month's move therefore appears primarily as an adjustment to prevailing money market conditions at home and abroad, and seems to have been little influenced by the domestic economic situation. Although industrial output had been declining early this year, and during January-April was running about 6 per cent below the same months of 1957, production edged upward in May and there are indications of a further advance in June.

EXCHANGE RATES

Despite international tension and seasonal demand for dollars, American-account sterling acted remarkably well during July. Early in the month, good commercial demand for sterling strengthened the rate to $\$2.80^{2\frac{9}{32}}$. As seasonal demand for dollars in London developed, particularly from tobacco interests, the rate eased to $\$2.80\frac{1}{2}$ and

then dipped quickly to $\$2.80$ following the news of the Iraqi coup at midmonth. The rate, however, recovered to the $\$2.80\frac{9}{16}$ level by the month end. There was very little evidence that the British authorities found it necessary to lend more than token support to the rate.

The forward discounts for three and six months' sterling moved rather widely between $1^{1\frac{1}{16}}$ and $2^{5\frac{1}{16}}$ cents and $3\frac{3}{8}$ and $4\frac{3}{32}$ cents, respectively, during the month. The wider discounts followed the revolution in Iraq, while discounts tended to narrow whenever offerings of forward dollars appeared in London or moderate commercial demand for forward sterling developed in New York.

Transferable sterling reacted more sharply than American-account sterling to the events in the Middle East, declining to $\$2.76^{2\frac{5}{32}}$ from an early July quotation of $\$2.78^{5/8}$, with the rate in New York reflecting principally the movements of the rate in Switzerland. This greater pressure on the transferable sterling-dollar rate paralleled the weakness of sterling in relation to Continental currencies, the latter rates reaching support levels for sterling during the month. By the month end, transferable sterling had recovered to about the $\$2.78$ level. Securities sterling ranged between $\$2.77$ and $\$2.78^{5/8}$ during the month and, from time to time, was quoted higher than transferable sterling. The market for securities sterling was relatively active during July with investor demand reflecting some interest in British oil stocks.

The Canadian dollar moved erratically between $\$1.04$ and $\$1.04\frac{3}{8}$ in a comparatively small market. Although the Canadian dollar was more offered than bid in the market, the demand on the part of commercial interests and from the Continent occasionally strengthened the rate. Some demand also resulted from the conversion of United States dollar proceeds of securities sales in the New York market, although such demand was on a considerably reduced scale as compared with past months. As the month ended, the Canadian dollar was quoted at $\$1.04\frac{1}{64}$.

Sterling: A Year of Recovery

Sterling has recovered from the difficulties of 1957 and has weathered the American recession in a manner that few would have dared predict a year ago. The vigorous measures to safeguard the currency, announced by the British Government in mid-September 1957, brought a marked strengthening in sterling rates and reversed the drain in Britain's gold and dollar reserves which had dropped sharply during July-September to a five-year low

of $\$1,850$ million. Even after allowing for Britain's drawing on the Export-Import Bank line of credit and its postponement of payments on the United States and Canadian postwar loans, the rise in these reserves from October onward was one of the most rapid in Britain's history. Indeed, it not only offset the third-quarter losses but pushed the reserves up to $\$3,084$ million at the end of July 1958, the highest since September 1951.

ADVERSE PRESSURES IN 1957

This recovery was very largely attributable to the elimination of factors that had weakened sterling during January-September 1957. Early in 1957 sterling was still convalescing from the Suez difficulties of the previous autumn, which had involved a sharp setback from the recovery achieved under the British Government's financial restraint policy of 1955 and 1956.¹ Largely because of this policy, it is true, Britain's over-all balance of payments on current account was still in surplus during January-June 1957, but its balance with the dollar area had swung into deficit because of the rise in its imports of petroleum and petroleum products from the dollar area and the reduction of dollar earnings of British oil companies from their overseas operations. Of more basic importance in early 1957, however, were factors that created uncertainty about the stability of sterling. This uncertainty stemmed in part from persisting troubles in the Middle East, where Britain has large investments, but mainly from difficulties in Britain itself.

Upward pressure on wages continued unabated during the winter of 1956-57 despite the fact that, for the first time since early 1954, unemployment in Britain exceeded the number of job vacancies. Faced with this continuing wage pressure, the government took the view that an expansion of production was necessary to meet the expected growth of consumer expenditures. Actually production did recover to its earlier highs, the labor market tightened once more, and, with retail and export prices still rising, a continuance of the wage-price spiral seemed in prospect.

It thus became a question whether Britain could expect even to maintain the surplus in its balance of payments, to say nothing of expanding it to a level commensurate with Britain's heavy obligations to other countries, and this uncertainty led to a weakening of confidence in sterling. As a result, there was a marked rise early in 1957 in the flow of sterling capital into nonsterling countries. Indicative of the flow to the dollar area was the \$141 million rise in net British purchases of United States long-term securities in January-June 1957 above a year earlier and the \$48 million rise in securities purchased in Canada. The outflow of sterling capital to nonsterling-nondollar countries also rose, with the result that Britain's net dollar payments to these countries were sharply increased.

Dollar losses on these accounts, however, were more than offset by a variety of other factors, especially the increased flow of private United States long-term capital

to Britain and the rebuilding by dollar-area residents of their sterling balances, which had been sharply reduced during 1956. Britain's reserves (which comprise the central reserve for the entire sterling area) also benefited from special dollar receipts, notably the reimbursement, under a revision of the United States and Canadian postwar loan agreements, of \$104 million in interest that had been paid into suspense accounts in December 1956, as well as the \$200 million transfer to Britain in connection with India's drawings on the International Monetary Fund. Despite the pressure on sterling, therefore, Britain's dollar reserves rose by \$248 million in January-June 1957.

The adverse pressures on sterling were greatly intensified during the third quarter of 1957. The overseas sterling area's (OSA) trade deficit with nonsterling countries, already enlarged in January-June 1957 by the rise in imports, was further increased by the seasonal decline in third-quarter exports. At the same time, an intense wave of currency speculation was set off in Europe in August 1957 by what was in effect a partial devaluing of the French franc, as well as by a growing belief that the Deutsche mark was about to be revalued and that, in a general realignment of parities, sterling might be depreciated. Hence, funds were withdrawn from London on a very large scale, swamping the favorable effects of the substantial third-quarter build-up, for debt repayment purposes, in Germany's special sterling balances. Britain consequently lost \$531 million in gold and dollars during the third quarter, and \$129 million more during October (when, in accordance with the normal arrangements, the previous month's European Payments Union deficit was settled), for a total loss equivalent to more than one quarter of Britain's gold and dollar reserves at the end of June.

RENEWED STRENGTH SINCE SEPTEMBER 1957

Drastic measures announced by the British Government on September 19, 1957 put an end to this reserve drain. The government unequivocally reaffirmed that it intended to maintain the existing exchange parity of \$2.80 to the pound and that it did not intend to allow the margins to widen. To implement this policy the government declared that it would, if necessary, draw on credits previously granted on a stand-by basis by the International Monetary Fund and by the United States Export-Import Bank. It also tightened severely its domestic anti-inflationary policies. The Bank of England's discount rate was increased from 5 per cent to 7, and instructions were issued to the London clearing banks to hold the average level of

¹ See *Sterling After Suez*, published in the May 1957 issue of this Review.

advances during the next twelve months to the average of the previous twelve, and to the Capital Issues Committee to take a more restrictive and critical attitude toward applications to borrow. Finally, the government curbed the investment programs of the public authorities and nationalized industries.

The tightening of the government's financial policies was followed by a distinct reduction of domestic inflationary pressures and by a large-scale reversal of the speculative pressures that had depressed sterling. In these changes, a major role was played by the improvement in Britain's terms of trade which resulted from the decline in the country's import prices. This improvement enabled Britain to maintain unchanged the physical volume of its imports while in effect paying for them with a somewhat smaller volume of exports. In the six months ended March 1958 there was consequently an increase from a year earlier in the goods and services (measured in constant prices) made available to the domestic economy through Britain's international transactions, and these supplies were further augmented by a modest expansion in the country's gross domestic product. On the other hand, domestic demand (also measured in constant prices) rose only moderately, with continued increases in personal consumption and fixed investment being partly offset by reductions in the goods and services absorbed by the public authorities as well as in inventories. At the same time, unemployment increased and in June 1958 was about double the reported job vacancies. The upward pressure on wages continued but was considerably moderated, the index of weekly wage rates rising only 1 per cent in the nine months ended June 1958 compared with a 5 per cent increase in the nine months a year earlier.

The decline in Britain's import prices played a major role not only in the achievement of better balance in the domestic economy, but also in the strengthening of the country's international economic position. Although the physical volume of Britain's imports remained virtually unchanged, their value in the nine months ended June 1958 declined 8 per cent below a year earlier. Since the fall in the value of Britain's exports was considerably smaller, the country's merchandise trade deficit was cut by more than one third. Although much of this improvement was with the overseas sterling countries, Britain's trade position with the United States also strengthened markedly as the exceptionally large petroleum imports of early 1957 tapered off and as Britain's commercial exports—paced by enlarged automobiles sales—rose 5 per cent in the nine months ended June 1958 over a year earlier.

Significant as was the strengthening of Britain's trade

balance, it was overshadowed in importance by the return flow of speculative funds into sterling, owing in part to a favorable change in the "leads-and-lags" mechanism. Earlier, and especially during the summer of 1957, purchases of sterling had been delayed as long as possible, sterling receipts had been sold forthwith, and dollar requirements had been covered promptly. Such bearish tendencies were reversed after the September 19 measures convinced the foreign exchange market of the British Government's determination to maintain the value of the pound. It is indicative of this change that the sterling balances of nonsterling-area residents (excluding those held for special purposes by West Germany), which had declined about \$200 million in the six months ended September 1957, rose by \$73 million in the following six months, almost half of the rise being in the London balances of dollar-area residents. Changes in the "errors and omissions" items of both the British and the United States balances of payments also point to a major shift, favorable to sterling, in speculative movements.

Finally, Britain's reserves benefited from additional special dollar receipts. As one of its measures to support sterling, the British Government in October 1957 drew \$250 million of its \$500 million line of credit at the Export-Import Bank. The government also availed itself of its right, granted under the revision of the United States and Canadian postwar loan agreements, to defer \$176 million in payments due at the end of December 1957. However, even after allowing for these special factors, the \$1,234 million rise in Britain's reserves in the ten months ended July 1958 was striking testimony to the efficacy of the government's measures to eliminate inflationary pressures in the domestic economy and restore confidence in sterling.

STRAINS IN THE OVERSEAS STERLING AREA

The improvement in Britain's position appears the more remarkable when account is taken of the OSA countries' continuing difficulties, which have been reflected in sharp declines in their sterling exchange reserves. These dropped by \$188 million equivalent in the nine months ended September 1957, and by no less than \$451 million equivalent in the following six months. Significant reserve losses were recorded by New Zealand, South Africa, and Pakistan, but the bulk of the loss was attributable to India. The OSA's sterling balances had thus been reduced by March 1958 to the lowest level in six years, while those of India in particular are at the lowest since that country became independent.

In these difficulties, the role of the American recession

has frequently been exaggerated. There is no denying, of course, that the prices of many important commodities exported by the OSA have declined considerably. In mid-March 1958 the London prices of lead, tin, copper, sisal, rubber, and wool were all lower than they had been two years earlier, before the outbreak of the Suez difficulties; only tea, cocoa, and jute among the major sterling commodities were higher. However, the most important of the factors making for these price declines considerably antedated the American recession. Some go as far back as the early postwar and Korean periods when many of the major commodities exported by the OSA were in short supply. To overcome these shortages, vigorous efforts were then made to expand production, especially of minerals, but additional supplies began to come on to the markets only in early 1956, after a marked expansion in consumption and various short-term factors (including strikes in producing countries) had pushed prices up to vulnerable levels. With the elimination of these short-term factors and with new low-cost facilities coming into operation, commodity prices had already come under considerable strain when the downward pressure was aggravated by the leveling-off of world economic activity and by the United States recession.

Moreover, the ensuing decline in commodity prices resulted more in a slowing-down in the growth of OSA exports than in any decline in their value. The latter was actually 5 per cent higher in 1957 than a year earlier because of an increase in physical volume. Only in the final quarter of 1957 did their value dip slightly below a year earlier, mainly because of declines in OSA exports to Britain and to the OEEC countries. In contrast, OSA exports to other nonsterling countries, including significantly enough the dollar area, were higher in October-December 1957 than they had been a year earlier. These divergent trends continued in the early months of 1958, when OSA exports to Britain were lower than a year earlier and those to the United States were higher, the latter increase being apparently attributable to the shifting of United States purchases away from marginal domestic producers to the aforementioned low-cost sources of supply that have been opened up overseas in recent years.

A rapid rise in imports, rather than any decline in exports, thus seems to have been the major factor in the OSA's difficulties. The implementation of ambitious development plans pushed New Zealand's and South Africa's 1957 imports up by about one tenth over 1956 and those of India and Pakistan up by one quarter. With imports rising more rapidly than exports, the OSA's trade deficit rose to £230 million in 1957, about one-third

larger than in 1956, as a result of roughly equal increases in the area's deficit with Britain and with nonsterling countries. With the United States, the trade deficit was four times higher than in 1956, but much of this increase reflected enlarged OSA imports of surplus agricultural commodities sold under United States aid programs and involving payment by the recipient countries in local currencies only.

Faced with widening trade deficits and sharp declines in their sterling reserves, various OSA countries have raised additional funds not only from international institutions but also in the London and New York markets. At the same time these countries have sought to strengthen their trade balances through the adoption of domestic restraints, the stimulation of exports, and the tightening of direct controls over imports, and by the spring of 1958 the rise in their imports seemed to be ending. Thus, by April-May 1958 the earlier expansion in Britain's exports to the OSA had stopped, at least temporarily. In the case of United States exports to the OSA, the earlier rise has actually been reversed, March-May 1958 showing a drop of 11 per cent from a year earlier. These developments, together with the upturn in the prices of many OSA commodities during the spring and early summer of 1958, augur well for a strengthening in the OSA's international economic position.

POLICIES FOR RENEWED GROWTH

The measures adopted in the sterling countries had by the spring of 1958 transformed the problem with which the British Government was faced. Adverse speculative pressure on sterling had ended and the gold and dollar reserves were rising rapidly. However, since sales to the OSA were no longer increasing and those to the OEEC countries were actually declining, the continued, though moderate, rise in sales to the dollar area was not sufficient to prevent a decline in total British exports. At the same time, aggregate domestic expenditure was increasing little, if at all. The conditions that had made necessary the drastic measures of September 1957 had thus disappeared, and the government accordingly began gradually to ease its financial policies.

The process began with a reduction in the Bank of England's discount rate in March 1958 to 6 per cent from the 7 per cent crisis rate that had been maintained since the previous September. It was continued in the government's budget for the fiscal year beginning April 1958, under which tax incentives for business investments were moderately increased, while in May and in June the Bank of England's discount rate was further reduced, on

each occasion by $\frac{1}{2}$ per cent, to 5 per cent. Simultaneously, market yields on government securities adjusted downward and rates charged by such government lending agencies as the Public Works Loan Board were also cut in accordance with the official policy of keeping them in line with the market.

Then, in a major move toward an easier financial policy, the government announced on July 3 that the control exercised by the Capital Issues Committee would be loosened. A letter from the Chancellor, which served both as a directive to the committee and as a guide for the commercial banks' policy on advances, gave priority to investments that would strengthen the balance of payments of both Britain and the OSA, and indicated that investments in areas of persistent unemployment in the United Kingdom should also be favored. In addition, the committee, which had theretofore been required to approve only new issues that were of "immediate urgency", was authorized to approve also those that "anticipated future needs". The £10,000 minimum, below which new issues did not require the committee's approval, was raised to £50,000 and restrictions were lifted on the utilization of bank financing in the raising of new capital. Moreover, the ceiling that had been placed on commercial bank advances in September was withdrawn, and new arrangements were provisionally adopted under which the authorities, if it should again become necessary, could restrict both the liquidity of the commercial banks and their ability to extend credit, by requiring banks to hold special deposits at the Bank of England.²

In relaxing its financial policies, the British Government is preparing the way for renewed economic growth, especially in the field of industrial investment. At the same time, it has emphasized that Britain's basic economic objectives remain unchanged. "We are determined", the Chancellor said when he announced the July 3 measures, "not to return to inflationary conditions." The government, he said, puts the strength of sterling, the soundness of Britain's international position, and price stability first. Being acutely aware that its freedom of

action is limited, the government accordingly has stressed the importance of renewed economic growth not only in Britain but also in other major industrial countries, and has called for new measures of international cooperation, including steps to increase the flow of long-term capital to less-developed areas.

While there is much to be said in favor of such measures, it is important not to underestimate the factors, already operating, that have brought about the very notable recovery of sterling in the past year. Foremost among these have been the policies, followed by the British Government since last September, to restore confidence in sterling. Beyond this, movements in the United States balance of payments have thus far been exceedingly favorable to sterling. In January-September 1957, when the outflow of sterling funds from Britain and the OSA was adversely affecting Britain's gold and dollar reserves, the unfavorable consequences were partly offset by substantial inflows of capital from the United States. It is true that the downturn in economic activity in the United States—the world's largest consumer of most primary commodities—aggravated the difficulties of the OSA but, as already noted, most of these difficulties antedated the recession by many months. Moreover, in the six months ended March 1958, United States imports from the sterling area were higher than a year earlier, United States exports were lower, and the rate of United States capital outflow exceeded the high rate attained in January-September 1957, not only because of Britain's drawing on its Export-Import Bank line of credit but also because of an increase in the rate of outflow to the OSA. These factors were so strong that they not only offset the impact of heavy drawings by the OSA countries on their London balances and presumably also on the central dollar reserves, but also pushed those reserves up by \$1,234 million in the ten months ended July 1958. With gold and dollar reserves now standing at \$3,084 million and with another billion dollars available on a stand-by basis from the International Monetary Fund and the Export-Import Bank, Britain is now in a much improved position to meet the uncertainties of the future.

² For details of these arrangements, see this *Review*, p. 114.