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OF NEW YORK

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The Business Situation

Business activity has continued to improve across a broad front, although the level of unemployment has remained substantially unchanged. The expansion in the aggregate output of goods and services which began in the second quarter, when gross national product (GNP) rose by about 1 per cent, is evidently continuing through the summer. The Federal Reserve Board's index of industrial production rose for the third consecutive month in July, reaching 7 percentage points above the recession low of April and 2 percentage points above the level of June (see chart). The increased productive activity was spread widely throughout the economy, as almost all major categories of manufacturing and mining, seasonally adjusted, showed improved or stable levels of output in both June and July. Similarly, the value of new construction continued to rise in July and August, led by expanding outlays in private residential building. Private housing starts attained the highest level in two and a half years, after seasonal adjustment.

Judging by the movement of weekly indicators, the growth in production appears to have extended through August. While the auto assembly rate dropped sharply in August to permit plant change-over to the 1959 models, steel production has risen each week since the beginning of July. Freight carloadings (miscellaneous and less than carload), which were about 20 per cent below the levels in the comparable period of 1957 during the first half of this year, improved in August to about 15 per cent less than a year ago. In summary, the recovery has made further progress, but there is quite some distance still to go before sizable unused human and material resources are reabsorbed.

EMPLOYMENT AND PRICES

Although the rise in production has been accompanied by a small increase in employment, the volume of unemployment also has expanded slightly. Total employment of wage and salary workers rose by 130,000 in July, on a seasonally adjusted basis, with employment in manufacturing enterprises increasing for the second consecutive month. On the other hand, the seasonally adjusted unemployment rate rose in July to 7.3 per cent of the civilian labor force —a level within the range of the small variations which have marked the rate of unemployment since March. The simultaneous rise in output and unemployment during July was evidently the result of a combination of factors, including declining employment in agriculture and higher output per man-hour in industry. In the middle of August total unemployment claims were still more than double the level of the same period in 1956 or 1957.

The consumer price index edged upward by 0.2 percentage points in July; while consumer durable goods held steady, the prices of services and nondurable goods rose somewhat. However, food prices are expected to recede and exercise a downward pressure on the over-all consumer price index in coming months. The wholesale prices of farm products and processed foods declined in July for the second consecutive month, offsetting a rise in industrial prices, with the result that the combined wholesale commodity price index was unchanged in July. Since the latter part of July, the weekly price index for industrial commodities has shown little change despite the price rise in steel; the increase in steel prices, averaging about 3 per cent over the full product-list, was not so large as the summer increases of the past several years. Some other basic materials rose in early August but fell by midmonth, contributing to a general downward tendency in wholesale prices as the month progressed. Mail order catalogue prices for the fall season are reported to be appreciably lower than those of a year ago. Some close observers conclude that upward pressure on both wholesale and consumer prices has at least temporarily subsided.

INFLUENCES ON AGGREGATE DEMAND

As the chart indicates, the change in the rate of business inventory liquidation was the most powerful factor contributing to the upturn in GNP in the second quarter. The liquidation of business inventories in the second quarter amounted to $8 billion, at a seasonally adjusted annual rate, but was $1.5 billion less than in the first quarter; in contrast, liquidation of inventories increased by $7.2 billion between the fourth quarter of 1957 and the first quarter of 1958. The improvement during the second quarter, as more recently, was almost entirely at the wholesale and retail level, where policies are more directly influenced by expectations concerning expenditures by households and other end-users. A restocking of inventories by retailers and wholesalers began in June, evidently in anticipation of rising sales. In manufacturing, on the other hand, production has continued to lag behind

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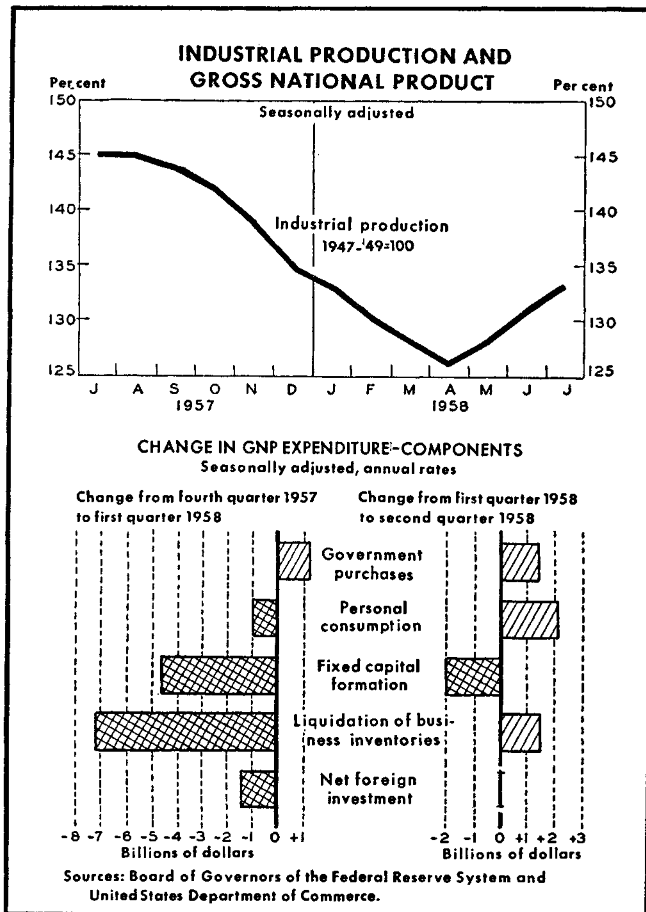

deliveries, so that stocks of both finished goods and materials declined further—a decline that accelerated through June, but diminished in pace during July.

Consumer spending rose in the second quarter in response to the persistent rise in personal income. The July level of personal income, at a seasonally adjusted annual rate, reached a new peak of $354.4 billion (exclusive of nonrecurrent, retroactive pay awards by the Federal Government), up $2.4 billion over June. Three fifths of this increase was derived from higher government payrolls and transfer payments, such as greater unemployment compensation outlays. But despite the rise in personal income, retail sales in July (according to the preliminary report) did not increase from the June level. Indeed, for the past three months, these sales have remained virtually unchanged at a rate which, although substantially above the recession lows, is still well short of the 1957 peaks. The stability in retail sales may reflect to some extent the leveling-off in the cost of living; the earlier increase in sales had been partly associated with the rising prices of food and other necessities.

Whether consumer buying is to show substantial new gains during the coming months may depend largely on the public's reception of the 1959 auto models, and on the extent to which consumers will be willing to burden themselves with additional debt to purchase cars and other major consumer goods. The ratio of consumer debt to consumer income, though reduced somewhat by the decline in instalment borrowing this year, remains above the ratio prevailing at any time before 1957. In the past, spurts in retail sales of consumer goods usually have depended to an important extent on substantial increases in instalment credit. Since February of this year repayments of consumer credit, seasonally adjusted, have exceeded new extensions, but the gap has been narrowing recently.

In other sectors of aggregate demand, the outlook is also uncertain. Since the beginning of this year, expanding government purchases have been a source of strength in offsetting deflationary pressures, and government spending has remained at a high level throughout the summer. Concern with the size of the potential budget deficit has been growing, however, and may act to restrain the growth of Federal expenditures, although there has been no evidence thus far of restriction on the placing of defense orders.

Prospects for business investment expenditures on plant and equipment appear to be improving somewhat. Although private fixed capital formation expenditures are down sharply from year-ago levels and are likely to decline still further in the coming months, the decrease may be less than previously intended if consumption expenditures move upward sharply. However, the existence of unutilized capacity may continue for some time to act as a drag on new capital outlays.

There no longer appears to be substantial doubt that a recovery is under way, but the vigor and the sustainability of the upswing remain uncertain. The decline in the rate of inventory liquidation evidently triggered the turnaround last spring. Because of the central role played by businessmen's inventory policies, the precipitous rate at which stocks have been liquidated may even lend strength to the recovery—cessation of inventory liquidation and rebuilding of stocks by manufacturers could contribute substantially to increasing the speed of the upswing. But to sustain the revival of business activity there will have to be a rising trend of final demand. Among the components of such demand, consumer spending, due to its predominant size, will be of crucial importance in the coming months.

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Money Market In August

Market interest rates moved sharply upward during August. By the end of the month, yields on long-term Government securities were only slightly below the peak reached last October. Rate adjustments were especially pronounced on securities of shorter maturity, as expectations of generally rising yields were reinforced by less easy money-market conditions. Basically, these expectations reflected the market's reaction to the improving trend of business, to prospective heavy Treasury borrowing requirements, and to renewed fears in some quarters of inflationary dangers. Actions taken by the Federal Reserve System during the month also played a role in the rate adjustments that took place. On August 4 the Board of Governors announced an increase from 50 per cent to 70 per cent in margin requirements for securities transactions. On August 14 the Federal Reserve Bank of San Francisco announced an increase in its discount rate from 1¾ per cent to 2 per cent effective on the following day, and this was followed later in the month by similar announcements by the Federal Reserve Banks of Dallas, Atlanta, and Kansas City. In addition, free reserves of member banks were reduced during the month.

MEMBER BANK RESERVE POSITIONS

Free reserves of member banks averaged $406 million during the four statement weeks ended August 27, compared with monthly averages ranging from $484 million to $547 million in the previous five months. Moreover, the trend during the month was downward, the daily average falling from $530 million in the week ended July 30 to $306 million in the final statement week of August. Average member bank borrowing was $207 million in August, compared with $109 million in July, and average excess reserves declined from $656 million to $613 million.

During the first two statement weeks, operating factors absorbed $431 million of member bank reserves. An increase in currency in circulation accounted for about half of the loss. A further net absorption of $238 million resulted from a sharp bulge in average required reserves, partly reflecting bank acquisition of the 1½ per cent tax anticipation certificates offered by the Treasury late in July. These reserve needs were more than offset temporarily by an increase in System holdings of Government securities, including the new 1⅝ per cent certificates of indebtedness purchased on a "when-issued" basis in late July for payment on August 1, but redemptions and sales from System holdings soon offset a major part of these purchases.

Over the last two statement weeks, reserve gains and losses from the various operating factors were relatively small and largely offsetting, except for swings in float which resulted in some net addition to reserves in the week of August 20 and a net drain in the week of August 27. System securities sales and redemptions during this period, amounting to about half the net addition to System holdings during the earlier part of the month, resulted in a net contraction of reserves. Total System holdings of Treasury securities increased by $300 million between July 30 and August 27, as a decline of $789 million in Treasury bills was more than offset by an increase of $1,089 million in other securities.

The reduction in over-all availability of member bank reserves, as well as a substantial outflow of funds from the New York City banks early in the month, resulted in some tightening in the money market during August. The liquidation of short-term Treasury obligations and strong demands for Federal funds by New York City banks adjusting their reserve positions added to the upward pressures on Treasury bill yields and other short-term interest

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

Factor	Daily averages—week ended				Net changes
	Aug. 6	Aug. 13	Aug. 20	Aug. 27	
Operating transactions					
Treasury operations*	− 119	+ 160	− 21	+ 51	+ 71
Federal Reserve float	+ 5	− 54	+ 234	− 151	+ 34
Currency in circulation	− 84	− 121	− 4	+ 46	− 163
Gold and foreign account	− 48	− 50	− 27	+ 25	− 100
Other deposits, etc.	− 124	+ 3	− 39	+ 2	− 158
Total	− 368	− 63	+ 142	− 25	− 314
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 205	+ 386	− 220	− 149	+ 222
Held under repurchase agreements	—	+ 20	− 20	—	—
Loans, discounts, and advances:					
Member bank borrowings	+ 4	+ 117	− 13	+ 54	+ 162
Other	—	—	—	+ 1	+ 1
Bankers' acceptances:					
Bought outright	− 5	+ 3	− 2	− 1	− 5
Under repurchase agreements	—	—	—	—	—
Total	+ 202	+ 527	− 254	− 97	+ 378
Total reserves	− 166	+ 464	− 112	− 122	+ 64
Effect of change in required reserves†	+ 92	− 330	+ 40	+ 79	− 119
Excess reserves†	− 74	+ 134	− 72	− 43	− 55
Daily average level of member bank:					
Borrowings from Reserve Banks	112	229	216	270	207‡
Excess reserves†	560	694	622	576	613‡

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 August 27.

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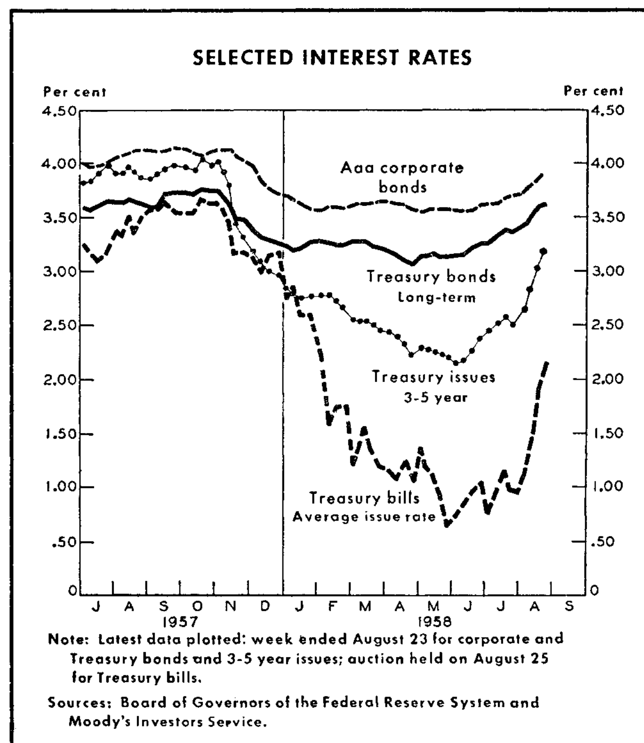
rates; the effective rate for Federal funds ranged for the most part from 1 per cent to 1¾ per cent, whereas in July this rate was generally below 1 per cent. A small volume of trading at rates above 1¾ per cent was reported occasionally in Federal Reserve Districts that had moved to a higher discount rate.

GOVERNMENT SECURITIES MARKET

The sharp declines in the prices of Treasury notes and bonds which occurred during July extended through the first half of August, as speculative holdings of recently issued Treasury securities continued to be liquidated and buyers held back in anticipation of further yield increases. Although long-term issues subsequently displayed relative stability until late in the month, over the month as a whole yields on long-term Government bonds rose by about 20 basis points to 3.63 per cent, only slightly below the peak reached last October. There also was a narrowing of yield differentials among the different maturity classes of Government securities, as yields on Treasury bills and three-to-five-year issues rose during the month to their highest levels since January and last November, respectively (see chart).

After a temporary strengthening of the Treasury bond market late in July, a renewed wave of liquidation by speculative holders swept the market in early August and price quotations dropped sharply. The selling expanded as bond prices declined following the announcement after the close of business on August 4 that the Board of Governors had increased margin requirements on transactions in listed securities from 50 per cent to 70 per cent. This move was interpreted in the market as foreshadowing further moves by the System toward a lessened degree of credit ease. Market pressures were aggravated by margin calls on borrowers carrying Government securities on thin margins, and by uneasiness concerning further liquidation of securities by temporary holders. By mid-month, speculative liquidation had subsided temporarily and signs appeared of sporadic investor demand at the higher yield levels in the long-term area. The announcement of the discount rate increase at the San Francisco Bank on August 14 appeared to have been at least partly anticipated by downward price adjustments earlier in the month. However, prices of short and intermediate securities continued to move down on balance during the remainder of the month, and toward the end of the month the long-term sector again was subject to some speculative selling. Over the month as a whole, Treasury issues maturing before 1963 lost as much as $5\frac{3}{16}$ points, those in the 1963-72 range lost up to 5¼ points, and long-term bonds closed $3\frac{13}{16}$ to $4\frac{13}{16}$ lower.



Note: Latest data plotted: week ended August 23 for corporate and Treasury bonds and 3-5 year issues; auction held on August 25 for Treasury bills.
Sources: Board of Governors of the Federal Reserve System and Moody's Investors Service.

The rise in Treasury bill yields, which began in June and continued irregularly through July, was accelerated in August as selling pressures extended to the short-term sector. The market effects of expectations of generally higher yields were reinforced by liquidation of bills by New York City banks, which were under fairly steady reserve pressure during the month, and by reduced demand from other investors. The average issuing rates established in the weekly Treasury bill auctions advanced at each successive auction during the month, from a rate of 0.984 per cent on July 28 to 1.165 per cent on August 4, 1.524 per cent on August 11, 1.895 per cent on August 18, 2.162 per cent on August 25, and 2.462 per cent on August 29. (The last auction was held early because of the Labor Day holiday.)

OTHER SECURITIES MARKETS

The factors operative in the Government securities market during August extended to the markets for other short- and long-term debt instruments, and yields on seasoned corporate and municipal bonds rose further in relatively light trading, while rates on new issues advanced even more rapidly. A number of issues originally marketed in June and July were "cut loose" by the dissolution of underwriting syndicates and became available at sharply lower prices, while proposed new issues aggregating about $300 million were postponed to await more settled market

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conditions. Over the month, average yields on seasoned Aaa corporates rose 26 basis points to 3.97 per cent, yields on new corporate issues 54 basis points to 4.39 per cent, and on seasoned Aaa municipals 38 basis points to 3.22 per cent.

The volume of new offerings during the month was moderate, but expectations of a renewed build-up of the calendar in September, reinforced by the announcement of a forthcoming $350 million industrial debenture in that month (the largest of the year), contributed to the market's heavy tone. Corporate bonds for new capital purposes and municipal bonds publicly offered during August amounted to an estimated $205 million for corporates and $315 million for municipals. The total of $520 million during the month was well below the total for August 1957 and substantially less than the $1,220 million offered in July. The few large corporate issues floated at progressively higher yields during the month encountered mixed receptions, while several municipal issues of moderate size offered during the month met an indifferent response and moved rather slowly.

Upward pressures on yields were also strong in the market for private short-term debt instruments, in sympathy with the sharp adjustments in the Treasury bill market. The rate on bankers' acceptances, which had remained unchanged since late May, was advanced in five steps during August by 1 per cent on acceptances of all maturities, bringing the offering rate on 90-day acceptances from 1⅛ per cent to 2⅛ per cent. Rates on 30-to-89-day paper directly placed by major finance companies, which were reduced by ¼ per cent to 1 per cent late in July after having remained unchanged since April, were adjusted sharply upward in several steps during August. The most recent increase of ½ per cent, effective September 2, brought the rate to 2¼ per cent, up 1¼ per cent for the month. The rate on prime commercial paper rose in six steps to 2⅝ per cent from 1½ per cent at the end of July.

MEMBER BANK CREDIT

Total loans and investments of the weekly reporting member banks increased by $931 million during the four weeks ended August 20, as a sharp increase in securities holdings, consisting mainly of the 1½ per cent tax anticipation certificates subscribed for last month, more than offset a further net decline in loans. The rise in bank investments was concentrated entirely in the week ended August 6, when the banks took delivery of their allotments of the 1½ per cent tax anticipation certificates. Holdings of Government securities declined during each of the other three weeks, while holdings of other securities were little changed on balance.

Total loans of the weekly reporting banks fell by $333 million during the four-week period, as continued sharp reductions in securities loans offset a moderate net increase in business loans and small net increases in other loan categories. The decline in securities loans partly reflected the lower volume of underwriting activity during the period and apparently a reduction in dealer inventories of Government securities. The moderate net increase of $239 million in business loans compares with a rise of $435 million in the same period last year.

CHANGES IN LIQUIDITY

It is estimated that all commercial banks increased their holdings of marketable Government securities by $5.6 billion during the first half of 1958. This increase was concentrated entirely in less liquid issues of more than five years' maturity, however. Bank holdings of Treasury securities maturing within one year declined by $0.3 billion, while holdings of obligations in the one-to-five-year class fell by $2.4 billion. This shift toward issues of longer maturity largely reflects the considerable lengthening of the marketable public debt that occurred during the first half of this year. More recent data for the weekly reporting banks suggest that there has been some increase in

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 Aug. 20, 1958
	July 30	Aug. 6	Aug. 13	Aug. 20	
Assets					
Loans and investments:					
Loans:					
Commercial and industrial loans	− 118	+ 55	+ 65	+ 237	− 2,443
Agricultural loans	+ 12	− 3	+ 15	+ 18	+ 138
Securities loans	− 163	− 302	− 216	− 93	− 303
Real estate loans	+ 20	− 3	+ 52	+ 40	+ 298
All other loans (largely consumer)	+ 26	+ 19	− 9	+ 17	− 253
Total loans adjusted*	− 222	− 236	− 94	+ 219	− 2,613
Investments:					
U. S. Government securities:					
Treasury bills	+ 35	+ 226	− 319	− 179	− 237
Other	− 99	+1,944	− 188	− 189	+ 7,111
Total	− 64	+2,170	− 507	− 368	+ 6,874
Other securities	− 27	+ 20	+ 25	+ 15	+ 1,508
Total investments	− 91	+2,190	− 482	− 353	+ 8,382
Total loans and investments adjusted*	− 313	+1,954	− 576	− 134	+ 5,769
Loans to banks	− 151	+ 281	+ 19	− 301	+ 636
Loans adjusted* and "other" securities	− 249	− 216	− 69	+ 234	− 1,105
Liabilities					
Demand deposits adjusted	+ 207	− 884	− 179	− 261	− 1,564
Time deposits except Government	+ 33	+ 60	− 12	− 54	+ 4,050
U. S. Government deposits	− 490	+1,659	− 276	+ 275	+ 1,896
Interbank demand deposits:					
Domestic	− 167	+ 637	+ 97	− 530	− 879
Foreign	− 20	+ 16	− 35	− 16	− 101

* 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.

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holdings of short-term Treasury securities since the middle of the year. Between July 2 and August 20 these banks increased their holdings of Treasury bills and certificates by $2.2 billion.

Comprehensive measures of commercial bank liquidity are not available on an up-to-date basis, while current data on the weekly reporting banks are subject to sharp swings from week to week and even from month to month. One liquidity measure available for the weekly reporting member banks—the ratio of selected liquid assets (such as Treasury bills and certificates, loans to banks and to brokers and dealers, vault cash, and balances with domestic banks) to deposits—averaged 15 per cent during the second quarter of 1958 for banks in New York City, compared with 11 per cent during the same period of 1957 and a previous second-quarter high of 17 per cent in 1954. On the other hand, the increase in this ratio for weekly reporting banks outside New York City was relatively small; an average ratio of 11 per cent in the second quarter of 1958 compares with a figure of 9 per cent in the same period last year and a previous second-quarter high of 14 per cent in 1954. Since the middle of the year, of course, bank acquisition of short-term securities issued by the Treasury in recent financings has led to some further increase in liquidity.

No very satisfactory yardstick is available of the liquidity of the economy as a whole, but one commonly employed measure is the ratio of the private money supply (demand deposits adjusted and currency outside banks) to gross national product. This ratio was 0.31 in the second quarter of 1958, compared with a previous low of 0.30 in the third quarter of 1957 and a previous high of 0.35 reached in the second and third quarters of 1954. Incomplete data on nonfinancial corporations suggest that the ratio of cash and Government securities to total current liabilities, a commonly used measure of corporate liquidity, increased somewhat during the first half of this year but remains below 1954-55 levels.

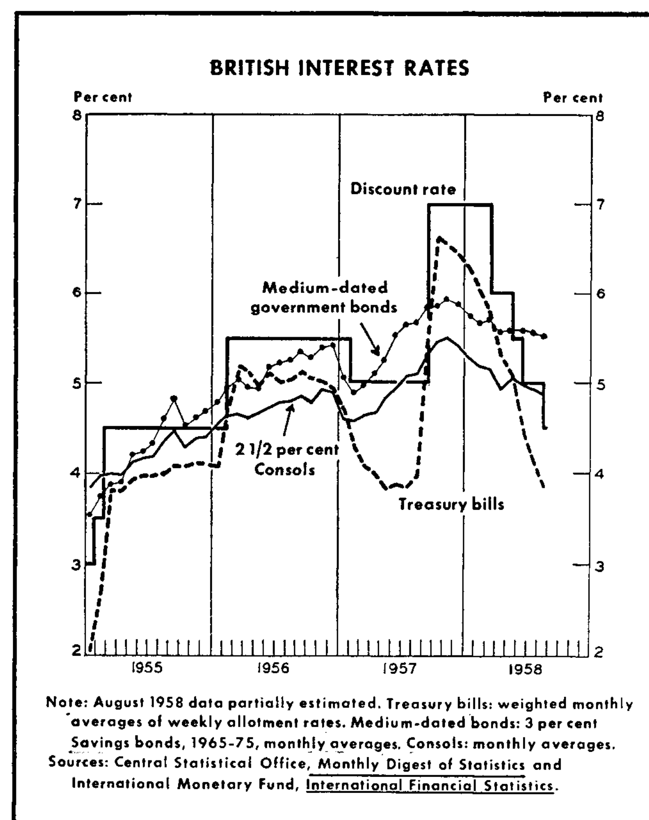
International Monetary Developments

MONETARY TRENDS AND POLICIES

UNITED KINGDOM. The Bank of England lowered its discount rate to 4½ per cent, effective August 14, from the 5 per cent rate that had been in force since June 19. Last month's reduction, the fourth this year, restores the rate to the level in effect during the twelve months ended February 1956 (see chart). The Bank of England stated that the move was in line with other recent moves designed to ease credit restrictions and was justified by domestic developments as well as by the continuing strength of sterling.

The improvement in Britain's external position has been reflected most vividly in British gold and dollar reserves, which in July rose $8 million despite heavy payments to the European Payments Union and sharp, albeit brief, pressure on sterling under the impact of the Middle East crisis; on July 31 reserves stood at $3,084 million, the highest level since September 1951. On the domestic side, industrial production (seasonally adjusted) for June was reportedly some 5 per cent below the all-time high attained a year earlier. During the second quarter, moreover, unemployment declined less than seasonally, although in mid-July it amounted to only 1.9 per cent of the total number of employed.

Last month's discount rate reduction, like the previous ones this year, had been anticipated by the money market. The average Treasury bill tender rate, which had stood at



Note: August 1958 data partially estimated. Treasury bills: weighted monthly averages of weekly allotment rates. Medium-dated bonds: 3 per cent Savings bonds, 1965-75, monthly averages. Consols: monthly averages.
Sources: Central Statistical Office, Monthly Digest of Statistics and International Monetary Fund, International Financial Statistics.

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4.16 per cent at the final July tender, fell to 4.01 and 3.87, respectively, at the first and second August tenders; following the discount rate decrease it dropped to 3.72 per cent, the lowest since April 1955. The yield on 2½ per cent Consols which had reached a low for the year of 4.83 per cent on August 14, closed at 4.89 on August 29.

DENMARK. The National Bank of Denmark reduced its discount rate to 4½ per cent from 5, effective August 15; the previous rate had been in force since April 19, when it had been lowered from 5½ per cent. The reduction came against a background of increasing market liquidity and falling interest rates, developments that reflected primarily the considerable strengthening of the country's international position that has occurred since the beginning of this year. During the first six months a rise in both agricultural and industrial exports, coupled with a decline in imports, reduced the trade deficit to $27 million equivalent from $139 million in January-June 1957. By the end of July the national bank's net gold and foreign exchange holdings had risen to $88 million equivalent, almost double the level of December 31, 1957.

BELGIUM. The National Bank of Belgium reduced its discount rate to 3½ per cent from 3¾, effective August 28. The reduction, the fourth this year, apparently reflects lower interest rates in some other European countries and the increasingly liquid financial markets in Belgium due to large increases in official reserves and reduced investment demand. At the same time, industrial activity has shown no definite signs of a general upswing, although some improvement has been noted in a few industries.

FRANCE. Despite the recent improvement in France's budgetary and foreign exchange position, the French National Credit Council has declared that it considers inadvisable any basic changes in the monetary restraint measures adopted since mid-1957. However, during August, in order to assist certain branches of industry now encountering marketing difficulties, the Council lowered to 30 per cent from 35 the minimum downpayment for instalment purchases of a wide range of consumer durables but left unchanged their twelve-month maximum repayment period. The Bank of France also lowered to 10 per cent from 12 the penalty rate applicable to discounts in excess of 110 per cent of the ceiling set for each individual credit institution; the 8 per cent penalty rate for discounts between 100 and 110 per cent of a bank's ceiling, as well as the 5 per cent discount rate, remain unchanged.

EXCHANGE RATES

American-account sterling quotations during August continued to move against the seasonal pressures which have usually tended to bring the rate toward the lower support level for sterling of $2.78 at this time of the year. In the early part of the month good commercial demand for sterling in New York, an easing in the dollar demand from London, and a further increase in the United Kingdom's gold and dollar reserves during July (when the market anticipated a decline) resulted in a rise in the spot sterling quotation to $\$2.80^{31}/_{32}$ by August 7. Thereafter, as sterling became offered, in part by oil companies, and as the market confidently anticipated a reduction in the Bank of England's discount rate, the quotation gradually declined to $\$2.80^{7}/_{16}$ on August 12. On August 14, after the reduction in the British discount rate from 5 to 4½ per cent was announced, the quotation advanced to approximately $2.80⅝ on renewed commercial demand. The rate fluctuated at about this level until August 22 when it began to ease to $\$2.80^{3}/_{32}$ at the month end.

Discounts on forward sterling narrowed during most of the month in a rather small market, with notable reductions occurring just before and after the August 14 change in the Bank of England's discount rate. Three and six months' forward deliveries were at discounts of $^{27}/_{32}$ and $1^{13}/_{16}$ cents, respectively, on August 20, compared with $1^{27}/_{32}$ and $3^{17}/_{32}$ cents at the beginning of the month. Thereafter, only minor fluctuations occurred, and at the end of August three and six months' sterling were at discounts of ⅞ and $1^{25}/_{32}$ cents.

Transferable-sterling quotations generally advanced from $2.78 at the beginning of August to $2.78¾ by August 21. During the period there was good demand for transferable sterling in New York which was substantially offset by offerings from Continental sources. In the closing days of the month the quotation eased slightly, and on August 29 the rate stood at $\$2.78^{3}/_{32}$. The securities-sterling quotation ranged between $2.77½ and $2.78¼ during August; at the month end it was $2.77¾.

The Canadian dollar moved somewhat erratically, although within a fairly narrow range, during the first half of August in a market characterized by reduced activity, due in part to the absence of new offerings of Canadian securities in the New York market. Shortly after midmonth, however, on developing demand for United States dollars by Canadian commercial interests and offerings of Canadian dollars from London, the quotation began a rather marked downward movement and reached $\$1.02^{49}/_{64}$ on August 29, the lowest since early April. Contributing to the decline in the Canadian dollar rate was the absence of offerings by certain Canadian commercial interests of United States dollars customarily earned from exports. At the end of August the Canadian dollar was quoted at $\$1.02^{51}/_{64}$.

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Earnings and Expenses of Second District Member Banks in the First Half of 1958

Second District member banks experienced a smaller increase in net operating income in the first half of 1958 than in recent years. Net current operating earnings before income taxes rose by only 1.4 per cent over the first half of 1957, this being the smallest increase in the last eight years. Nonetheless, net profits after income taxes of Second District member banks increased by 49.3 per cent, largely as the result of gains derived from the sale of securities, in contrast to the losses on securities taken in the first half of 1957. For all member banks in the country, net current operating earnings before taxes rose by 2.8 per cent and net profits after income taxes by 47.3 per cent.

Total operating income of Second District member banks rose to $884 million, 7 per cent higher than for the first half of 1957. At New York City banks the principal increase was in income from securities, reflecting the substantial rise in securities holdings; income from loans was only slightly higher. At other member banks in the District, however, income from loans increased fully as much as income from investments. For all member banks in the District, the yield on loans remained at 4.6 per cent, unchanged from a year earlier; the yield on investments moved slightly upward from 2.4 per cent to 2.5 per cent.

Total operating expenses rose by 11 per cent over the first half of 1957 to $536.7 million. Salaries and wages, the largest operating expense component, increased by 5.9 per cent, while interest paid on time deposits rose 41.5 per cent for the central reserve city banks and 25.2 per cent for the rest of the District. Interest and discounts paid on borrowed money, a very small item in total operating expenses, declined by nearly 51 per cent in the District.

As indicated by the accompanying table the central reserve city banks, as well as the other banks in the District, raised their dividend pay outs—the former by 10.3 per cent and the latter by 24.7 per cent. In contrast to the first half of 1957, retained earnings of Second District member banks exceeded dividend payments to stockholders.

Earnings and Expenses of Member Banks in the Second Federal Reserve District During the First Six Months of 1956-58
(Dollar amounts in millions)

Item	New York central reserve city banks			Reserve city and country banks		
	1956	1957	1958	1956	1957	1958
Number of banks	18	18	18	590	558	528
Earnings:						
On United States Government securities	67.7	68.2	80.9	43.9	45.5	49.8
On other securities	24.1	22.6	29.8	14.2	16.0	21.4
On loans (including service charges and fees on loans)	297.3	351.0	354.5	152.6	174.0	185.3
Service charges on deposit accounts	12.0	12.8	13.3	17.8	20.8	22.6
Trust department earnings	49.9	57.6	59.4	5.5	6.5	7.2
Other current earnings	34.9	38.9	47.3	11.5	11.9	12.5
Total current operating earnings	485.9	551.1	585.2	245.5	274.7	298.8
Expenses:						
Salaries and wages—officers and employees	132.9	141.7	149.3	71.9	78.3	83.8
Interest on time deposits (including savings deposits)	27.6	38.6	54.6	38.1	52.1	65.1
Interest and discount on borrowed money	5.1	7.0	3.5	1.1	0.9	0.4
Taxes other than on net income	7.5	8.1	8.2	6.2	6.9	7.3
Recurring depreciation on banking house, furniture, and fixtures	4.7	5.5	6.6	4.9	6.1	6.8
Other current operating expenses	80.9	88.1	95.7	46.8	50.0	55.4
Total current operating expenses	258.7	289.0	317.9	169.0	194.3	218.8
Net current operating earnings before income taxes	227.2	262.1	267.3	76.5	80.4	80.0
Recoveries, charge-offs, transfers to and from valuation reserves, and securities profits—net*	−26.6	−30.6	+61.4	−15.4	−18.0	+13.3
Net profits before income taxes	200.6	231.5	328.7	61.1	62.4	93.3
Taxes on net income	103.1	113.6	156.2	26.3	26.3	35.9
Net profits after income taxes	97.5	117.9	172.5	34.8	36.1	57.4
Cash dividends paid or declared	62.7	70.1	77.3	15.9	18.6	23.2
Retained earnings	34.8	47.8	95.2	18.9	17.5	34.2

* No breakdown of nonrecurring items is shown because these figures are usually highly tentative at the midyear.
Sources: Board of Governors of the Federal Reserve System, 1956; 1957 and 1958 figures compiled by the Federal Reserve Bank of New York.

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The United States Recession and Foreign Reserves

The 1957-58 recession in the United States has not resulted in heavy drains upon foreign gold and dollar reserves, as the experience of earlier recessions had led many observers to expect. On the contrary, in the nine months ended June 1958 foreign countries added about $1.3 billion to their gold and liquid dollar assets through transactions with this country. Over the same period, perhaps another $700-800 million was acquired from international institutions, new gold production, and other sources. These gains are as welcome as they were generally unexpected. In offsetting the losses which preceded them, they have gone far toward allaying fears of an impending crisis of international liquidity. The question remains, however, whether these gains were solely the product of a fortunate combination of special factors or whether business fluctuations in the United States are becoming less important as a factor influencing world economic activity.

EXPERIENCE IN PREVIOUS RECESSIONS

United States recessions have long been viewed with apprehension abroad not only because of their adverse effects on foreign economic activity, but also because of their repercussions on foreign reserves of gold and dollars. In the interwar and early postwar periods a sag in the United States economy was usually accompanied by a considerable drop in the value of imports as both prices and volume fell off; United States exports, however, declined relatively less, or even rose, in value. The deterioration in the foreign trade balances of foreign countries vis-à-vis the United States was often reinforced by a deterioration on service account as well. It was axiomatic to expect foreign reserves to be adversely affected.

With this background, the experience in 1953-54, when foreign gold and dollar holdings continued to rise despite the United States recession, was at first puzzling. This was particularly so since both merchandise imports and exports behaved more or less according to the usual pattern, the United States trade surplus increasing by $1 billion in the year ended September 1954 over the preceding twelve months. Analyzing the experience, many observers pointed out that foreign countries were gaining heavily at the beginning of the recession in their transactions with this country. They noted that the rate of gain did, in fact, drop from $2.1 billion annually in the year before the recession to $1.5 billion in the year ended in September 1954. The relative stability of commodity prices and a rise in the outflow of private United States capital were seen as factors moderating the impact of the recession on foreign reserves. What would the result be, it was asked, if circumstances were less favorable the next time?

The onset of the United States recession in 1957 found external economic forces apparently in a more ominous constellation than in 1953-54. Foreign countries in the year ended September 1957 had experienced a large cash deficit in their transactions with the United States for the first time in over five years. The prices of industrial raw materials were falling, with little prospect that this would be checked by rising industrial activity in Europe and Japan. In the circumstances, with the outflow of private United States capital also slowing down, fears of a further depletion of foreign reserves were widespread. Since a large part of the International Monetary Fund's (IMF) convertible resources had already been utilized or committed, such a development could have had serious repercussions on international trade and economic activity.

FOREIGN DOLLAR GAINS IN THE RECESSION

In fact, however, the international reserves of foreign countries as a group mounted rapidly almost from the beginning of the recession. This resulted in considerable measure from the re-emergence of a foreign net cash surplus in transactions with the United States (see table). Two factors stand out boldly in this sharp reversal in the balance of United States payments and receipts. Merchandise trade failed to behave in accordance with previous patterns: imports held up remarkably well while exports dropped sharply. Over the same period there was a partial reversal of the heavy speculative movement of foreign capital into the United States which in particular had added greatly to the strain on sterling-area reserves during the preceding year. To an important extent both developments represent a reaction from the strains engendered in 1956-57 by the Suez hostilities and speculative attacks on sterling and other European currencies.

The blocking of the Suez Canal in November 1956 aggravated the strains on the international economy that had already arisen out of the rapid expansion of economic activity in a number of countries abroad. The United States had been increasingly called upon as a marginal supplier of both raw materials and finished goods, as internal demand in these countries had risen in excess of in-

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ternal resources. United States merchandise exports were further swelled by the Suez-induced spurt of petroleum shipments to Europe, scare buying of raw materials, and a rapid rise of surplus agricultural sales under special Government programs. The reserve strains engendered abroad were further aggravated by speculative capital flows to the United States associated with the flight from sterling —first, after the Canal's closing and, later, during the currency revaluation scare in the summer of 1957. The resulting rise in United States receipts swamped a sizable increase in United States payments arising from higher imports, larger Government lending, and a markedly greater outflow of private American capital. In the year ended September 1957, foreign countries as a whole ran a cash deficit of $1.1 billion in their transactions with the United States. The massive assistance of the IMF ($1.4 billion) did indeed offset the impact of this deficit on total foreign reserves. Still, the distribution of reserve gains was one-sided, with West Germany and Venezuela gaining heavily. Elsewhere reserve losses were general, amounting to over $1 billion in gold and dollar assets despite borrowing from the IMF and gold acquired from new production and other sources.

Against the background of unusual demands for United States goods in 1957, it is not surprising that United States commercial exports have since dropped back to the 1956 level, thus removing the pressure on foreign reserves they caused last year. A considerable part of the $1.9 billion decline in exports during the nine months ended this past June from the corresponding period a year before can be explained by the return of petroleum exports to normal, the disappearance of scare buying, and the fall in agricultural exports under Government programs. These special factors have, however, tended to divert attention from the greater sensitivity of our exports to economic activity abroad—a development which stems from the increasing importance of the United States as a supplier of raw materials, chemicals, and coal to Western Europe and Japan during boom periods.[1] The exuberant advance and subsequent tapering-off of production in these industrial areas influenced the parallel rise and fall of our exports. While exports to these regions and Canada have already dipped sharply, there remains the possibility that over-all exports may fall further from early 1958 levels if the primary-producing areas now losing reserves are forced to reduce their purchases.

United States receipts have dropped from year-ago levels, not only in consequence of the export decline, but also because of the partial reversal of speculative capital inflows into this country. Disinflationary policies abroad and the resurgence of confidence in sterling and other currencies have led to some outflow of portfolio capital from the United States and have stemmed the rush to the dollar previously reflected in the "errors and omissions" item in the United States balance of payments.

The strong performance of our imports of goods and services (see table) has attracted a great deal of attention. Merchandise imports, though easing in 1958, have not fallen more rapidly than domestic production—as had been usual in previous recessions. Imports in January-June 1958 were indeed only 3 per cent in value below the first six months of 1957, even though the index of industrial production had fallen 10 per cent over the same period. To an important extent this reflects the increased popularity in this country of foreign cars and other manufactured goods. Moreover, the volume of raw materials imported has also held up well (though the dollar value has fallen); there are some signs that marginal domestic production bore much of the brunt of reduced domestic demand. United States imports may possibly slip further as the year progresses, but it seems unlikely that the trade position of foreign countries will deteriorate seriously. In fact, if the recent upturn in the domestic economy develops sustained strength, imports might increase appreciably.

United States Transactions with Foreign Countries
(In millions of dollars)

Item	October 1956–March 1957	October 1957–March 1958	Change 1956/57–1957/58
United States payments			
Private:			
Imports of goods and services	8,586	8,670	+ 84
Capital outflow	1,887	1,106	− 781
Subtotal	*10,473*	*9,776*	*− 697*
Government transactions*	2,763	2,943	+ 180
Total payments	13,236	12,719	− 517
United States receipts			
Exports of goods and services†	13,180	12,129	−1,051
Foreign long-term investment	271	83	− 188
Errors and omissions	685	73	− 612
Total receipts	14,136	12,285	−1,851
Net foreign cash receipts (− =payments)	− 900	+ 434	+1,334
Foreign receipts from international institutions:			
IMF exchange transactions	+ 799	+ 137	− 662
Other	+ 36	+ 111	+ 75
Foreign gold and liquid dollar assets‡	− 65	+ 682	+ 747

Note: United States transactions with international institutions have been excluded to highlight the proximate sources of the dollar gains or losses of foreign countries.

* Military expenditures abroad, government pensions and nonmilitary grants, and net government loans.

† Excludes shipments under military-aid programs.

‡ Net foreign purchases of gold from the United States Treasury and changes in short-term dollar assets and holdings of long-term United States Government securities.

Source: United States Department of Commerce, *Survey of Current Business*; International Monetary Fund, *International Financial Statistics*.

[1] See "Recent Trends in United States Foreign Trade", *Monthly Review*, October 1957.

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Among other United States payments, the outflow of private capital has declined considerably from the unusually high levels reached in 1956 and the first half of 1957. Investment abroad by American companies has been much lower, partly because last year's special concession payments to Venezuela have not been repeated. However, low interest rates, available here until lately, sparked a host of new securities issues, including $375 million in International Bank bonds within the past year, and banks appear to be expanding their foreign commitments aggressively. Net Government lending, particularly through the Export-Import Bank, has been stepped up, in part because of a noteworthy attempt to assist countries endeavoring to surmount balance-of-payments difficulties.

Such difficulties have affected, in particular, the primary-producing countries which have had to draw on dollar or sterling holdings while the industrial areas have been increasing their gold and dollar holdings. In most cases the losses experienced by primary-producing countries started before the downturn here, having their roots in over-expansion and overimporting and a decline in raw material prices caused by growing supplies, but the recession has aggravated the difficulties of some countries. The terms of trade turned against the primary producers, as raw material prices slid downward while the prices of manufactures exhibited little weakness. Western Europe and Japan have probably benefited rather more from this development than the United States, however, since about 30 per cent of the United States exports consist of crude and semifinished materials.

It is, in fact, the industrial countries which account for the bulk of the increase in foreign gold and dollar assets. The United Kingdom, aided by the restoration of world-wide confidence in sterling, alone gained $1.2 billion in the ten months ended last July. A number of the industrial countries traditionally prefer to hold a large part of their international reserves in gold rather than dollars. In consequence, the outflow of gold from the United States has been heavier, and the build-up in foreign dollar assets smaller since late 1957, than is usually the case when total foreign gold and dollar assets are rising.

CONCLUSIONS

The substantial rise in foreign gold and dollar assets since September 1957 should relieve much of the concern felt earlier that international liquidity would be severely strained by the recent decline in United States business activity. The world in consequence seems well on its way toward taking in stride the third major strain in two years on the international trade and payments system. The Suez crisis, the stresses associated with the currency revaluation scare of the summer of 1957, and now the United States recession have all been met with a resilience which reflects underlying economic strength. Moreover, given the stronger performance of United States imports in the 1957-58 recession and the increased sensitivity of exports to industrial activity abroad, there is hope that United States recessions may have more moderate repercussions abroad than heretofore has been generally expected.

Perhaps the most heartening aspect of the past two years has been the willingness of national and international authorities to temper the impact of the successive shocks and to facilitate the return to greater balance. Significantly, many countries, entering the period with the rapid pace of domestic expansion posing a potential or actual threat to exchange reserves, undertook to deal with the basic problem of balanced growth through monetary and fiscal restraint rather than by resorting to a suppression of the symptoms of imbalance. Resort to direct interference with trade did not become general, and a cumulative return to trade restrictionism was avoided. The IMF made a notable contribution to this result through the aggressive commitment of its resources to cushion the effects of abnormal real demands and extraordinary capital flows on the reserves of the sterling area and many individual countries. The chief creditor nations, the United States and West Germany, gave important support to the containment of the unusual pressures of the several crises through special financial arrangements. While the record is far from perfect, it does warrant a measure of confidence that international economic institutions and cooperation have achieved a new maturity.

An immediate challenge to further constructive action is provided by the present reserve difficulties of the world's primary producers. These have found their dollar and sterling assets eroding further since last September, while the industrial areas—Western Europe and Japan—have been able to recoup a large part of their previous reserve losses. The setting appears propitious for a cooperative attack upon the fundamental problems posed by the general need for balanced economic growth and by the apparent end of the postwar period of raw material scarcity. In fact, the active consideration being given to a variety of measures dealing with these problems testifies to the common interest the industrial and primary-producing countries have in their solution. The importance to the entire world of a speedy resumption of growth abroad as well as in the United States is only too evident.

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Life Insurance Companies in the Postwar Capital Markets

Life insurance companies have played a strategic role in the postwar capital markets, mobilizing nearly one half of the savings channeled through savings institutions[1] between 1945 and 1957. In these years life companies supplied $70 billion of long-term funds to home buyers, private businesses, and State and local governments. About four fifths of the total represented new savings—as reflected in the net increase in total assets of these institutions[2] — and the remainder was obtained primarily by selling United States Government securities which during the war had risen to almost half of their total assets.

Aside from the substantial increase in total assets, the most striking feature of life companies' investment activities in the postwar period is the shift from Government securities to private obligations, and especially to corporate securities. Between 1945 and 1957, these institutions absorbed more than two thirds of the increase in long-term corporate debt. Among corporate bond issues (which accounted in 1957 for about two fifths of their total assets compared with less than one quarter in 1945), bonds of industrial and commercial enterprises (excluding railroads and public utilities) have become the most important single type of investment held by life companies (see table). This growth reflects in part the vast expansion of long-term corporate debt, and a large share of it has been accomplished through direct negotiation between life insurance companies and corporations, which bypasses the machinery of the public market. By the end of 1957, more than four fifths of life companies' industrial and miscellaneous bond portfolios had been acquired through direct negotiation.

Nonfarm real estate mortgages, the main type of asset owned in the 1920's, have recovered some of the ground lost during the depression of the 1930's, and between 1945 and 1957 life insurance companies acquired one quarter of the rise in nonfarm mortgages outstanding. These assets currently constitute one third of life companies' total investments. However, reflecting the changed structure of the mortgage market, a substantial part of their mortgage holdings consist of Federally underwritten real estate loans in contrast to those of the conventional type.

Within the postwar period the ebb and flow of investment opportunities in the corporate bond market, as reflected in the rise and decline of corporate bond prices, have mainly determined the availability of life insurance funds to other borrowers. Because corporate borrowers—to a greater extent than mortgage borrowers—can adjust quickly to rising interest rates and are willing to tailor their new issues to the needs of lenders, many life insurance companies have generally concentrated on corporate obligations when they were available at attractive rates—although they have, of course, simultaneously purchased other assets. Considerable variation exists in the portfolio practices of individual life insurance companies, but in the aggregate they have usually acquired mortgages (especially those guaranteed by the Veterans' Administration) on a large scale when new corporate bonds were scarce and rates relatively low. Fluctuations in the total volume of life insurance funds channeled into the private capital market as a whole have thus reflected changes in the supply and composition of new long-term debt rather than variations in the flow of savings to these institutions. In fact, when the flow of savings to life insurance com-

Assets of Life Insurance Companies, End of 1945 and 1957
(Amounts in millions of dollars)

Type of asset	1945		1957	
	Amount	Per cent of total	Amount	Per cent of total
Cash	780	1.7	1,292	1.3
U. S. Government securities	20,583	45.9	7,029	6.9
State and local government securities	1,047	2.3	3,163	3.1
Corporate bonds				
Total	10,060	22.5	40,832	40.3
Railroad	2,948	6.6	3,863	3.8
Public utility	5,212	11.6	15,252	15.1
Industrial and miscellaneous	1,900	4.3	21,717	21.4
Nonfarm mortgages				
Total	5,860	13.1	32,652	32.2
Federal Housing Administration	1,394	3.1	6,964	6.9
Veterans Administration	0	0	7,721	7.6
Conventional	4,466	10.0	17,967	17.7
Preferred and common stocks				
Total	999	2.2	3,391	3.3
Preferred	819	1.8	1,524	1.5
Common	180	0.4	1,867	1.8
Other assets	5,468	12.3	12,950	12.8
Total assets	44,797	100.0	101,309	100.0

Source: Compiled from Institute of Life Insurance, *Fact Book*.

[1] Savings institutions are defined to include life insurance companies, mutual savings banks, and savings and loan associations. The proportion would be somewhat smaller if the time deposits of commercial banks were included.

[2] Assets of life insurance companies are recorded at amortized value or market price; consequently, the net changes in assets presented here reflect bookkeeping revaluations as well as flows of funds between life companies and other sectors. However, these bookkeeping revaluations are relatively small (averaging less than $200 million for total assets on an annual basis) and do not affect the conclusions reached in this survey.

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panies was insufficient to meet the acceptable requests for funds, life insurance companies have sold Government securities and reinvested the proceeds in private obligations —although the pace of selling was, as a rule, dampened during periods of declining bond prices.

EARLY POSTWAR INVESTMENT ACTIVITIES

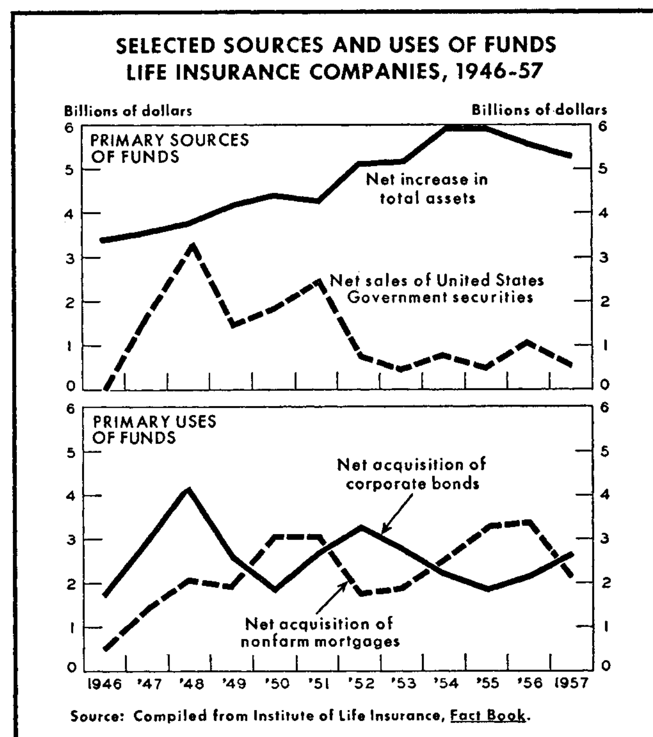
The participation of life insurance companies in the capital markets since World War II has passed through three broad phases: the early postwar years, 1946-49; the Korean war period, 1950-53, which ended with the 1954 recession; and the subsequent years of record peacetime financing.

At the end of 1945, the $20.6 billion of Federal Government securities owned by life insurance companies constituted nearly one half of their total assets. The bulk of their holdings was a legacy of the war years, but a part had also been accumulated in the preceding depression decade. The concentration on Governments, as well as the general decline in interest rates, had led to a progressive fall in the return on invested reserves, which meant an increase in the net cost of insurance—either through reduced dividends on existing policies or higher premiums on new policies. By 1945 the earnings rate had fallen to 3.11 per cent (before allowing for income taxes), compared with the record 5.18 per cent earned in 1923 and 3.45 per cent in 1940. Thus, one of the main postwar objectives of life insurance companies was to diversify their investment portfolios by replacing Government with higher-yielding private securities.

The swing of life companies from Government to private securities did not begin on a large scale until 1947, when the flow of life insurance funds into the private capital market rose sharply (see chart); in 1948 the flow increased further and exceeded $7 billion, a record which still stands. Approximately one third of the 1947 flow was obtained through net sales of Government issues, and the proportion jumped to nearly one half in 1948.

Real estate mortgages absorbed about one quarter of life insurance companies' funds in the early postwar years. Their acquisitions centered in VA-guaranteed real estate loans which accounted for more than one quarter of the rise in their nonfarm mortgage holdings between 1945 and 1948. Federally underwritten mortgages had attracted few life companies when the Federal Housing Administration (FHA) initiated its insurance program in the mid-1930's.

During the recession of 1948-49, the volume of funds supplied to the private capital market by life insurance companies decreased, the reduction being centered in corporate bonds. Although life companies' net mortgage



Source: Compiled from Institute of Life Insurance, Fact Book.

acquisitions also declined slightly during the recession, they greatly increased their forward commitments to buy mortgages as the 1949-50 housing boom enormously expanded the demand for real estate loans.

On balance, however, the lessened demand for long-term funds in 1949 reduced the opportunities of life companies to switch from Government securities into private obligations, and net liquidation was less than one half as large as in the year earlier. New savings continued to grow during the recession and provided almost three quarters of the total funds life companies supplied to the capital market, compared with just over one half in 1948.

THE IMPACT OF KOREA

The first effect of the Korean war on life insurance companies was to accelerate the accumulation of forward commitments to acquire real estate mortgages, which had been rising rapidly since mid-1949. Commitments were further built up when the advent of hostilities gave rise to expectations that Federal controls over the terms of mortgage lending would restrict real estate financing.

The enormous backlog of commitments had to be met after controls were introduced in July and October 1950. Because life insurance companies' assets increased more slowly as consumers rushed to buy durable goods, Government securities were liquidated on a massive scale in 1950

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and 1951. As the accompanying chart indicates, in each of these two years their nonfarm mortgage holdings rose by $3 billion, a record annual increase which was not equaled until 1955; VA-guaranteed mortgages accounted for over one quarter of the rise in 1950 and for nearly two fifths the next year.

During 1952-53, however, life insurance companies sharply reduced their participation in the Federally underwritten sector of the mortgage market. The reduction in mortgage lending was partly the result of Federal controls over mortgage terms which reduced the demand for Federally underwritten credit. It was also in keeping with life insurance companies' participation in the Voluntary Credit Restraint Program which sought to divert funds to the most essential uses. Life insurance companies thus financed a substantial part of the defense plants and defense-supporting facilities built by corporations during the Korean war. Moreover, Governments became more attractive to life insurance companies as interest rates rose after the Federal Reserve ceased supporting the Government securities market in the spring of 1951, and the capital losses involved in sales made them reluctant to shift out of Governments. Thus, in 1952-53 their Government holdings declined by only $1.2 billion or by less than one third of the reduction in the previous two years.

INVESTMENT BEHAVIOR, 1954-57

The onset of recession in mid-1953 reduced the corporate demand for funds and, in conjunction with increased availability of credit, led to a rapid decline in corporate yields. Just before the recession began, the maximum interest rates on Federally underwritten mortgages had been raised, and this provided a sizable yield differential which made the extension of real estate loans more attractive. Life insurance companies, therefore, curtailed their corporate lending and returned to the mortgage market on a large scale in 1954. Simultaneously, they made substantial forward commitments to buy nonfarm mortgages and subsequently added $3.3 billion of these assets to their portfolios both in 1955 and 1956. VA mortgages accounted for between one third and one half of the increase in life companies' nonfarm mortgage holdings in 1954, 1955, and 1956. With the sharp rise in bond yields and the strong corporate demands for funds in 1957, however, life companies again reduced their participation in the mortgage market, with most of the decline centering in VA mortgages.

In 1954, life insurance companies stepped up the sale of Government securities (see chart), prices of which had recovered strongly from the 1952-53 declines. Although their net sales of Governments declined in 1955, in the following year they rose sharply to over $1 billion. Life companies' new resources did not show a year-to-year increase in 1956 for the first time since 1951, so that sales were induced by the increased corporate demands for funds and rising corporate bond yields. Furthermore, some companies probably sold Governments because of the need to meet a large backlog of commitments. Although the slackening in the growth of new savings persisted through 1957, life insurance companies sold Governments at a much slower rate in that year, partly because their mortgage commitments had been considerably reduced and partly because prices of Governments were severely depressed until the closing months of the year.

RECENT PARTICIPATION IN CAPITAL MARKETS

During the first half of 1958, life insurance companies' assets increased somewhat faster than in the comparable period last year and thus reversed the year-to-year decline in the rate of growth evident since 1956. Indeed in the most recent period the inflow of new savings has been the main source of life companies. However, they have sold Government securities at a much slower pace than in the January-June months of 1957. Thus, on balance, the volume of funds supplied to the capital market in the six months ended June 1958 was slightly less, at $2.6 billion, than a year earlier.

Participation of life insurance companies in the mortgage market in the first half of 1958 has been the smallest for any comparable period since 1953. In contrast, life companies' net acquisition of corporate bonds increased during the first half of 1958, with virtually all of the rise centering in industrial and commercial bonds. This, of course, reflected the fulfilment of forward commitments made in 1957 as well as the strong corporate demand for funds this year.

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