

# FEDERAL RESERVE BANK OF NEW YORK



## MONTHLY REVIEW

DECEMBER 1958

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## The Business Situation

The revival of business activity continued in November, as output and employment benefited from the settlement of strikes which had previously impeded production of automobiles and other durables. Increased deliveries of new automobile models replenished dealer stocks, helping to slow inventory liquidation further, and construction activity continued to expand, reflecting the rising rate of housing starts and construction contract awards in the preceding months.

Nevertheless, the recovery still has a considerable distance to go before unemployment is reduced to the levels characteristic of past prosperity periods. The improvement in business continues to stem mainly from the same configuration of factors that have been propelling the recovery since its beginning—the declining rate of inventory liquidation, increased government spending, and the advance in housing and other construction. Outside the housing sector, an upsurge of private spending that would lead to a quick return to full prosperity is not yet in evidence.

All indications are that industrial production continued to advance in November, possibly more rapidly than in the preceding two months. Most significant was the elimination of some of the roadblocks which had held back recovery in the durable goods sector. The total output of hard goods did not expand at all in October, chiefly owing to work stoppages in the automobile, fabricated metals, machinery, and glass industries. But in November, automobile production roughly doubled, on a seasonally adjusted basis. However, steel output leveled off in November and industry sources have stated that operations are likely to remain in the neighborhood of 75 per cent of capacity through early next year.

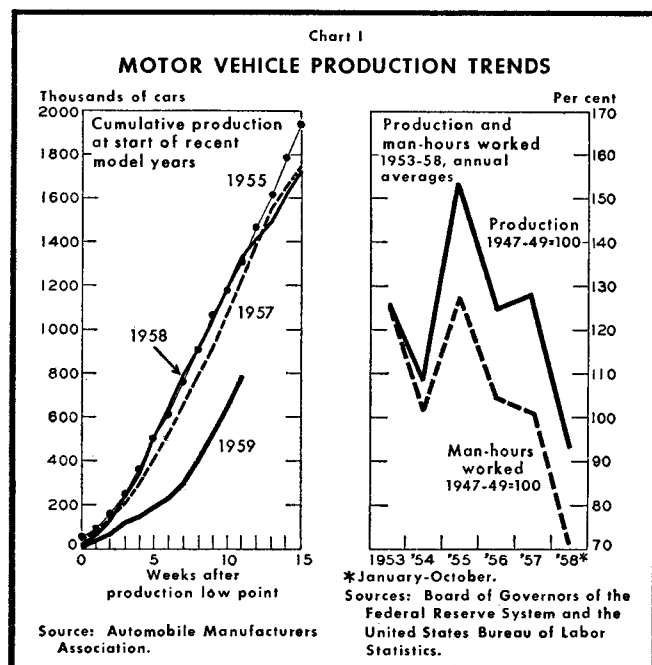
The recent strikes have also obscured employment trends. After rising for five successive months, nonfarm employment declined slightly in seasonally adjusted terms in October. The decline was wholly accounted for by job losses in factories turning out durable goods, mainly in the strike-affected industries mentioned above, but it appears that employment increased only about seasonally in the industries not affected by work stoppages. With respect to unemployment, the decrease in October was only moderately more than seasonal, but there was a further reduction in the number of adult men out of work and in long-term unemployment.

As indicated above, much of the slowing of recovery in September and October was attributable to the low

level of activity in the auto industry, which also retarded output and employment among suppliers in many important lines. The cut in auto output was unusually sharp in September during the model change-over period, and labor disputes prevented mass production of the 1959 models in October. Chart I shows the extent to which the output of 1959 model cars has lagged behind the auto industry's performance in early stages of recent model years. However, the marked step-up in production in November, when approximately 515,000 cars were turned out, suggests that the industry is planning to make up most of the lost production by the end of this year. Sales appeared to be picking up in November. But even if auto production in the 1959 model year should recover substantially, auto-worker employment may not be restored to its pre-recession level, since the industry's heavy investment in automation equipment reportedly has considerably reduced the manpower required to achieve a given production level. In rebounding sharply from the 1953-54 recession, it may be noted, the auto industry turned out 26 per cent more vehicles in 1955 than in 1953, with an increase of only 1 per cent in the number of man-hours worked (see Chart I).

The reception of the new model cars provides the most important test of the outlook for a substantial upturn in consumer demand. Growing incomes are one factor that may induce consumers to increase their purchases of major durables. Total personal income rose steadily during March-September this year (see Chart II), and the slight decline in October mainly reflected reduced wage and salary payments resulting from strikes. Moreover, the effect of price increases in slowing the growth of consumer purchasing power was less marked in the third quarter than earlier this year. Partly as a result, real disposable personal income showed the largest increase in over three years.

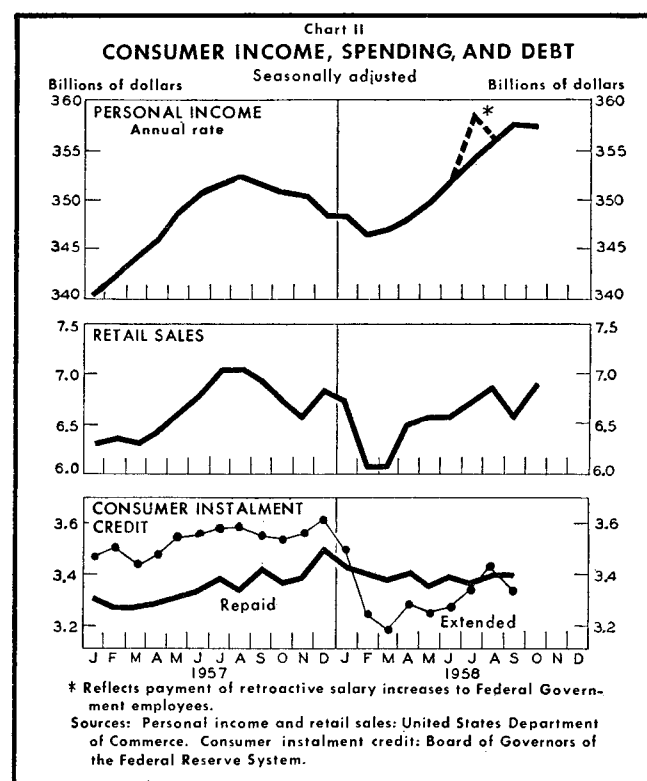
According to preliminary reports, retail sales rose by 2 per cent in October, after having fallen by a similar amount in September. Although the October sales increase was mainly the result of an improvement in durable goods sales, these were still 9 per cent below the pre-recession peak. In addition to rising incomes, the decline in consumer indebtedness that has taken place this year may encourage spending on durable goods; during January-October total consumer instalment credit outstanding fell by over \$1.0 billion, and the amount of automobile credit by more than \$1.2 billion.



Private spending has risen sharply only in the housing sector. In October, private housing starts rose to a seasonally adjusted annual rate of 1,260,000 units, the highest in three years, and the value of private residential construction put in place reached a record level. However, a sharp falling-off in October in applications for Federal Housing Administration commitments and requests for Veterans Administration appraisals of proposed home construction may indicate that the housing boom is tapering off; the October fall in the Government agencies' activities was more than seasonal, and in the case of the VA it was officially attributed to a tightening in the availability of mortgage credit for GI loans. The United States Commerce and Labor Departments issued a forecast in November that the rate of housing starts would continue high into early next year but would then slacken as mortgage money became less readily available; even so, it was estimated that, in view of the large number of homes started this year, spending on new private nonfarm residential construction would be some 13 per cent higher in 1959. The Departments also expect public construction expenditures to rise next year.

On the other hand, business construction spending is held likely to decline again next year, owing mainly to a further cut in factory building. This Government forecast is in line with recent reports of businessmen's 1959 capital spending plans. McGraw-Hill's preliminary

survey indicates that at present business plans to increase expenditures on new plant and equipment next year by only 0.5 per cent above the depressed 1958 level. While nonmanufacturing industries reportedly plan a 2 per cent increase in capital spending, manufacturers indicated that they would cut their expenditures 3 per cent despite their expectation that sales will average 9 per cent higher. The latter reflects the survey's findings that in September manufacturing companies were still operating at only 80 per cent of capacity. Plans for further substantial cuts in capital spending in 1959 have been reported in surveys conducted by the Federal Reserve Banks of Boston and Philadelphia. New England manufacturers anticipate spending 14 per cent less on new plant and equipment next year, while manufacturers in Philadelphia and adjoining areas say they will reduce their investment expenditures about 11 per cent. Experience suggests, however, that in recovery years businessmen are likely to spend a good deal more on new plant and equipment than they at first anticipate; in the fall of 1954 the McGraw-Hill survey indicated a 5 per cent cut in capital spending for 1955 but, as it turned out, investment expenditures rose 7 per cent. A substantial increase in business capital outlays, however, will probably await an acceleration of consumer demand.



## Money Market In November

Funds flowed smoothly through the money and capital markets during November, in an atmosphere of ready availability of credit to satisfy seasonal business and Treasury borrowing needs. The Treasury borrowed \$3 billion of new money with a midmonth auction of a June tax anticipation bill and later successfully refunded over \$12 billion of maturing securities with a new 11½-month certificate and a 2½-year note. All of the new issues were favorably received, and yields on Treasury bonds and notes moved moderately lower over the course of the month. System open market operations were primarily designed to maintain a steady tone in the money market, in order to facilitate the successful completion of these huge financing operations by forestalling developments which might lead to temporary kinks in the payments mechanism. Thus the effects on member bank reserves of a continuous outflow of currency into circulation and sizable fluctuations in float and Treasury balances were largely offset by System purchases or sales of Treasury bills. The effective rate for Federal funds hovered around 2 per cent over most of the first half of the month and moved to 2½ per cent thereafter.

On November 3 the Federal Reserve Banks of Boston and Kansas City announced an increase in their discount rates to 2½ from 2 per cent, effective on the following day. Similar announcements were made by the Federal Reserve Bank of San Francisco on November 5 and by the Federal Reserve Bank of New York on November 6. Discount rates at the other eight Reserve Banks had been raised to 2½ per cent in October.

### MEMBER BANK RESERVE POSITIONS

Although pressures on bank reserves were mild and for the most part steady during the month, there was considerable fluctuation from time to time in the various market factors that affect the reserve base. Since these influences on occasion worked in the same direction rather than offsetting each other, substantial System Open Market Account operations were necessary. Operations alternately supplied and withdrew reserves, thus smoothing out the fluctuations in reserve availability.

The behavior of float served to make reserves somewhat more volatile than usual. Heavy storms in the western States disrupted mail schedules around the middle of the month, so that the regular midmonth peak appeared somewhat earlier than normal, following a sharp drop in the first statement week of the month. In addition, labor stop-

pages on some major airlines during the last half of the month interfered with check collections and added to float at that time. As a result, float added \$222 million to reserves on an average basis over the four statement weeks ended in November.

Fluctuations in the Treasury's balances at the Reserve Banks were also fairly pronounced. A sharp fall in the first week of the period reflected in part substantially higher levels of expenditures than had been anticipated; later in the month, balances were rebuilt to more normal levels. In addition, a fairly continuous seasonal outflow of currency into circulation drained \$526 million of reserves over the four weeks ended November 26.

The System injected a substantial volume of reserves through open market operations in the first half of the month, when the currency drain was greatest. Later, however, as float rose to its midmonth peak, System open market operations were reversed, and average holdings of Government securities declined by \$249 million in the week ended November 19. The following week again called for large System Account purchases as an increase

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

Factor	Daily averages—week ended				Net changes
	Nov. 5	Nov. 12	Nov. 19	Nov. 26	
<b>Operating transactions</b>					
Treasury operations*	+ 185	- 46	- 109	+ 26	+ 56
Federal Reserve float	- 181	+ 138	+ 254	+ 11	+ 222
Currency in circulation	- 120	- 241	- 94	- 71	- 526
Gold and foreign account	- 24	- 41	+ 9	+ 9	- 47
Other deposits, etc.	- 68	+ 16	+ 38	+ 15	+ 1
Total	- 207	- 174	+ 97	- 10	- 294
<b>Direct Federal Reserve credit transactions</b>					
Government securities:					
Direct market purchases or sales	+ 80	+ 234	- 222	+ 186	+ 278
Held under repurchase agreements	+ 79	- 33	- 27	+ 137	+ 156
Loans, discounts, and advances:					
Member bank borrowings	- 53	+ 67	- 18	- 23	- 27
Other	-	-	-	-	-
Bankers' acceptances:					
Bought outright	+ 2	- 1	- 1	+ 2	+ 2
Under repurchase agreements	-	-	-	-	-
Total	+ 108	+ 268	- 268	+ 301	+ 410
<b>Total reserves</b>	- 99	+ 94	- 170	+ 291	+ 116
<b>Effect of change in required reserves†</b>	- 6	+ 79	+ 15	- 293	- 205
<b>Excess reserves‡</b>	- 105	+ 173	- 155	- 2	- 89
Daily average level of member bank:					
Borrowings from Reserve Banks	402	469	451	428	438†
Excess reserves‡	449	622	467	465	501‡

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 November 26.

in deposits, primarily associated with payment for the new tax anticipation bills, lifted required reserves by nearly \$300 million. Between October 29 and November 26, net System holdings of Treasury securities expanded by \$422 million, \$289 million in the form of outright holdings and \$133 million in the form of repurchase agreements.

Partly as a consequence of these offsetting actions, the weekly average level of free reserves remained within a \$15-160 million range; the average in the four weeks ended November 26 was \$63 million, \$33 million lower than in October. Member bank borrowings from the Reserve Banks in the four weeks ended November 26 averaged \$438 million, slightly greater than in the preceding month, while excess reserves were somewhat lower at \$501 million.

#### GOVERNMENT SECURITIES MARKET

Prices of Treasury notes and bonds generally moved upward over the month, although day-to-day movements were somewhat irregular. The average yield on long-term Treasury securities drifted downward over the month to 3.67 per cent on November 29, some 10 basis points below the end-of-October level. Trading in intermediate and longer term obligations was limited, as it had been during October, partly because of the usual uncertainties as the market awaited the announcements of the Treasury's financing plans.

After the close of the market on November 18, the Treasury made public its terms for refunding \$9.8 billion of  $3\frac{3}{4}$  per cent certificates maturing on December 1 and \$2.4 billion of  $2\frac{1}{2}$  per cent bonds maturing on December 15. Holders of the maturing issues were offered their choice of a  $3\frac{3}{8}$  per cent  $11\frac{1}{2}$ -month certificate due November 15, 1959, to be issued at a price of 99.95 per cent of face value (the equivalent of a 3.43 per cent yield), or a  $3\frac{5}{8}$  per cent 2-year  $5\frac{1}{2}$ -month note due May 15, 1961, to be issued at a price of 99.875 per cent of face value (the equivalent of a 3.68 per cent yield). The issuance by the Treasury of securities (other than bills or Savings bonds) at a discount represents a new departure in Treasury pricing practice, although the Treasury has occasionally offered securities at a premium on initial issue, most recently in June when the  $3\frac{1}{4}$  per cent bonds of 1985 were offered at  $100\frac{1}{2}$ . Fixing the issue price above par, as with the June bonds, or below par, as with the new certificates and notes, enabled the Treasury to set the effective interest rates on its new flotations with greater precision than would otherwise have been possible. The market reacted to the terms of the refunding offer favorably. Attrition on the \$4.3 billion publicly held portion of the maturing securities was only 10 per cent,

reflecting the attractive rates placed on the new issues. Federal Reserve holdings totaled \$7.9 billion of the \$12.2 billion total maturing issues.

After the books closed on the refunding, the new note traded at above-par bid for the remainder of the month, reaching as high as  $100\frac{1}{32}$ , and closed the month at par bid. Similarly, the new certificate traded above par, generally at  $100\frac{1}{32}$  or  $100\frac{3}{32}$  bid, and closed the month at  $100\frac{1}{32}$ . Over the month as a whole, prices of bonds and notes maturing before 1963 were mixed and closed from  $\frac{6}{32}$  lower to  $1\frac{2}{32}$  higher; longer bonds rose by as much as  $1\frac{20}{32}$  points.

Treasury bill yields, which had leveled out in the last two weeks of October after rising for about two months, again moved upward through much of November. Yields fell somewhat early in the first week of the month, but the Treasury's announcement at the close of trading on November 7 that it would raise about \$3 billion through a 214-day tax anticipation bill maturing next June turned yields on the regular three-month bills upward again. The TABs were sold in competitive auction at an average rate of discount of 2.997 per cent, well below the  $3\frac{1}{4}$  per cent discount set by the Treasury on the 219-day special bills sold in October. Commercial banks, which were permitted to credit their own and customers' subscriptions to their Tax and Loan Accounts, were fairly heavy bidders for the issue, and total tenders were almost double the amount of bills offered. The new TABs traded at yields slightly above issue rate in early trading and closed the month at 3.13 per cent (bid). The Treasury also announced, along with the details of the refunding offer, a program to raise \$2.6 billion by issuing a cycle of 26-week Treasury bills beginning on December 11 and running concurrently with the regular 13-week bills. The announcement indicated that the new program was mainly designed to restructure the short-term debt so as to provide a wider range of maturities at the shorter end of the Treasury list.

The bid on the longest outstanding regular bills reached a midmonth peak of 2.79 per cent, compared with 2.55 per cent at the end of October. They then moved downward to 2.64 per cent, before rising to close the month at 2.78 per cent. The average issuing rate in the regular weekly auctions rose during the first three weeks of the month. In the November 2 auction, the average issuing rate was 2.649 per cent, almost unchanged from the 2.647 rate established in the last bill offering in October. In the next two weekly auctions, the average issuing rate rose successively to 2.774 per cent on November 10 and to 2.876 on November 17. In the final bill auction, November 24, however, the average issuing rate fell back to 2.723.



## OTHER SECURITIES MARKETS

The market for seasoned corporate and municipal bonds was characterized by relatively light activity during November, with prices generally edging upward. Moody's index of yields on seasoned Aaa-rated corporates declined by 5 basis points over the month to 4.07 per cent on November 28, while the index for similarly rated municipals fell by 7 basis points to a yield of 3.14 per cent. New municipal issues met a fair reception, while new corporate bonds received a mixed response. In general, there was considerable investor selectivity so that some new flotations moved rather sluggishly.

The volume of corporate bonds for new capital purposes and municipal bonds publicly marketed during November totaled an estimated \$620 million, substantially below the \$1,420 million floated during September and slightly below the \$640 million sold in October. Flotations this November were some \$350 million smaller than the amount distributed last year. An estimated \$225 million of new corporate bonds for new capital purposes and \$395 million municipal bonds were publicly marketed in November.

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 Nov. 19, 1958
	Oct. 29	Nov. 5	Nov. 12	Nov. 19	
<b>Assets</b>					
Loans and investments:					
Loans:					
Commercial and industrial loans.....	+ 9	+ 105	+ 149	+ 7	- 1,809
Agricultural loans.....	+ 13	+ 2	+ 9	- 1	+ 180
Securities loans.....	+ 5	+ 93	+ 41	- 13	- 342
Real estate loans.....	+ 29	+ 35	+ 44	+ 47	+ 715
All other loans (largely consumer).....	+ 29	+ 27	+ 6	+ 45	+ 18
Total loans adjusted*.....	+ 84	+ 261	+ 247	+ 86	- 1,284
Investments:					
U. S. Government securities:					
Treasury bills.....	- 96	- 64	- 177	+ 10	- 349
Other.....	- 126	- 46	- 57	- 30	+ 5,194
Total.....	- 222	- 110	- 234	- 20	+ 4,845
Other securities.....	- 18	- 115	- 245	+ 1	+ 1,229
Total investments.....	- 240	- 225	- 479	- 19	+ 6,074
Total loans and investments adjusted*.....	- 156	+ 36	- 232	+ 67	+ 4,790
Loans to banks.....	- 1	+ 190	+ 327	- 625	+ 658
Loans adjusted* and "other" securities.....	+ 66	+ 146	+ 2	+ 87	- 55
<b>Liabilities</b>					
Demand deposits adjusted.....	+ 580	- 789	+ 380	- 28	- 41
Time deposits except Government.....	+ 3	- 81	- 165	- 103	+ 3,542
U. S. Government deposits.....	- 279	- 119	- 602	+ 796	- 413
Interbank demand deposits:					
Domestic.....	- 241	+ 683	- 108	- 416	- 1,153
Foreign.....	- 7	- 49	+ 19	+ 38	- 198

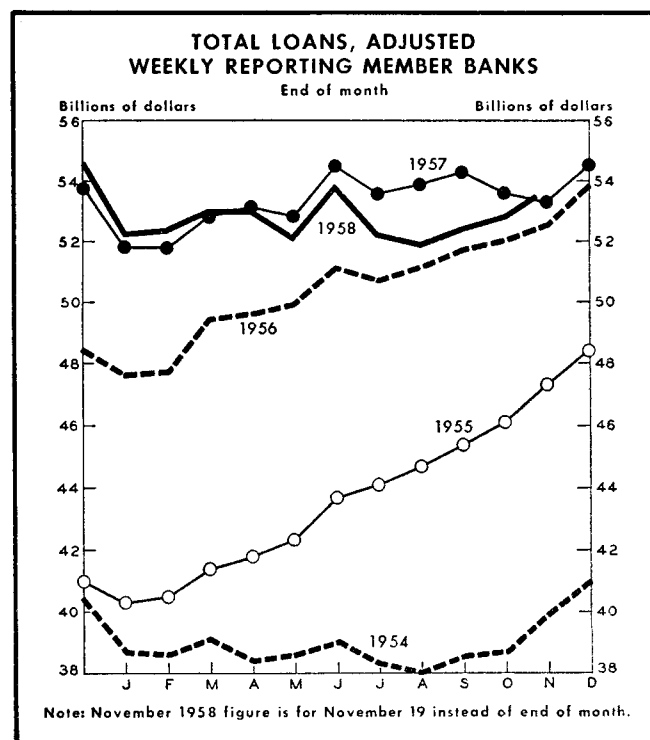
\* Exclusive of loans to banks and after deduction of valuation reserves; figures for the individual loan classifications are shown gross and may not, therefore, add to the totals shown.

On November 3, five major finance companies lowered their rates on directly placed paper. Four companies split 30- to 89-day paper into two maturities and reduced the rate on 30- to 59-day paper to  $1\frac{3}{4}$  per cent while retaining the  $2\frac{1}{2}$  per cent rate on 60- to 89-day paper. All five companies made reductions ranging from  $\frac{1}{8}$  to  $\frac{1}{4}$  of 1 per cent on paper of longer maturity. On November 10, commercial paper dealers cut their rates on prime 4- to 6-month paper from  $3\frac{1}{8}$  to 3 per cent but re-established the  $3\frac{1}{8}$  per cent rate on November 19.

## MEMBER BANK CREDIT

The level of credit outstanding at weekly reporting member banks moved down by \$285 million over the four weeks ended November 19, as the liquidation of investments more than offset a pronounced increase in loans. Over the four weeks, total loans adjusted rose by \$678 million, a gain that either equals or exceeds those of comparable periods in other recent years. With this resurgence of bank lending, loans at weekly reporting banks have about regained the levels of a year earlier (see chart).

The increase in loans was evident in almost every category. Business loans, which accounted for the largest increases, rose by \$270 million, whereas last year there was little change. The increase, however, was much



smaller than those in the corresponding weeks of 1955 and 1956. In addition to strong seasonal demand for credit by trade concerns, commodity dealers, and producers of food, liquor, and tobacco, there were also pronounced increases in loans to manufacturers of metals and metal goods, a group whose borrowing tends to move cyclically and which a year ago was repaying loans on balance. Borrowing to finance securities and real estate also increased substantially, as did the credit extended to the "all other" group that is dominated by consumer loans.

The decline of \$963 million in investments reflected the

liquidation of both Treasury and other securities. The decline in holdings of Government issues represented, in part, the aftermath of large Treasury financings in October in which banks played their usual role as underwriters. Weekly reporting banks liquidated \$327 million of Treasury bills on balance over the four weeks, thus bringing bill portfolios closer to the level prevailing before the week of October 8, when banks acquired their allotments of the special 219-day bill issue. Holdings of other Treasury issues also declined, partly reflecting the resale of the new 13-month notes issued in October.

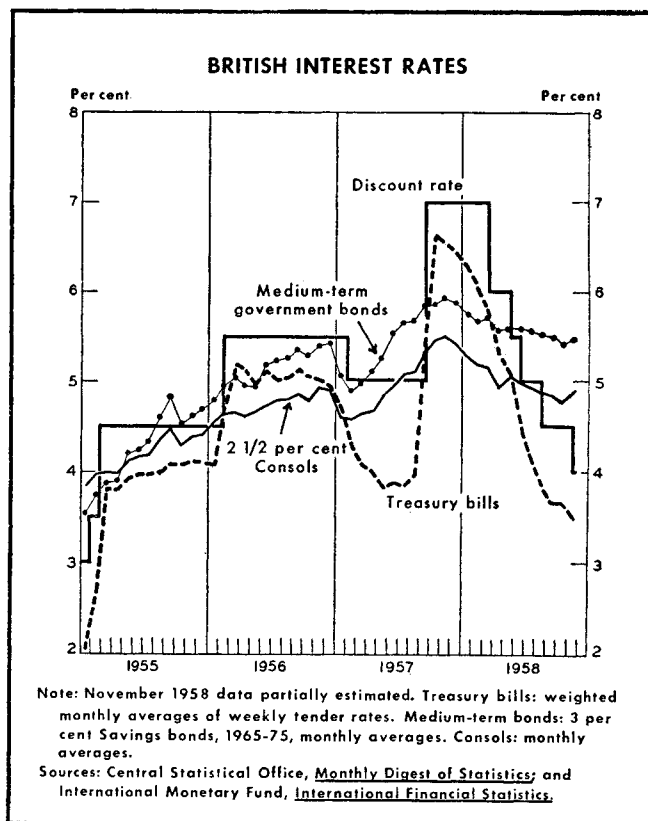
## International Monetary Developments

### MONETARY TRENDS AND POLICIES

**UNITED KINGDOM.** The Bank of England lowered its discount rate to 4 per cent, effective November 20, from the 4½ per cent rate in force since August 14. Last month's reduction, the fifth this year, leaves the rate the lowest since February 1955 (see chart). Like the four earlier cuts, and the substantial easing of credit restrictions and investment controls that has taken place since July, the Bank of England's latest move reflects the persisting strength of sterling, as well as the continued slack in the domestic economy. However, the possibility of renewed inflationary pressures in the near future is not entirely ruled out; in fact, a Bank of England spokesman stated, according to press reports, that the new low rate would provide for freedom of maneuver in either direction.

The continued improvement in Britain's external position is evidenced most vividly by the British gold and dollar reserves, which this year rose even in August and September when seasonal pressures against sterling are usually strongest. At the end of November, after fourteen consecutive monthly increases, reserves stood at \$3,215 million, 74 per cent above the September 1957 low and the highest since September 1951. Part of this increase was, of course, brought about by two special factors toward the close of 1957—the drawing of \$250 million on the Export-Import Bank line of credit and the deferment of the \$176 million year-end payments due on postwar United States and Canadian loans. On the domestic side, industrial production in September was 4.5 per cent below a year earlier, while unemployment rose more than seasonally in October to 2.3 per cent of the total employed.

Moreover, plans for new fixed investment by manufacturers in 1959 continue to fall short of this year's level. Nevertheless, the Chancellor of the Exchequer early in November labeled current unemployment a relatively short-term problem and expressed confidence that the



effect of the recent "operation re-expansion" measures would be quite marked.

As part of the government's program, the Chancellor on November 3 announced that public-investment expenditures in the fiscal year beginning April 1959 would be about 6 to 7 per cent above the current rate and should be sufficient to offset any foreseeable decline in private investment; however, the government did not intend to embark on a program involving a long-term increase of expenditures, which a few years hence might be competing excessively with the demands that the expected renewed expansion of private investment would generate. As an additional step, the authorities announced on November 5 their willingness to undertake the entire financing of building society mortgages on pre-1919 houses. Such government loans are expected to release £40-50 million now outstanding in loans on older houses, for financing mortgages on new or more modern properties. In addition, the government is increasing its grants to local authorities, and will supply financial assistance to two steel mills that have announced a considerable expansion of plant.

**NETHERLANDS.** The Netherlands Bank lowered its discount rate to 3 per cent from  $3\frac{1}{2}$ , effective November 15, in the fourth successive  $\frac{1}{2}$  per cent decrease since January of this year. The reduction, like the three preceding ones, appears to be primarily a technical adjustment to the decline in money market rates. The continuing high liquidity of the Amsterdam money market has stemmed, in turn, from the persistent improvement in the country's international position. Dutch official gold and foreign-exchange holdings have risen by \$150 million equivalent from the time of the previous discount rate reduction in mid-June through November 17, on which date they amounted to \$1,362 million, or 29 per cent more than at the end of 1957. These gains are due both to further progress in reducing the Dutch trade deficit and to the continued attractiveness of Dutch securities to foreign investors. The Netherlands Bank meanwhile has attempted to offset some of the increases in the liquidity of the banking system; it raised the commercial banks' reserve requirements from 4 to 10 per cent between February and August and also engaged intermittently in open market sales. Unlike last month's discount rate reduction in the United Kingdom, the latest move by the Netherlands Bank does not seem to have been influenced by any slackening of domestic economic activity. Indeed, there are indications that

industrial production, if it continues to develop favorably, may well recoup by the end of the year the decline which occurred in the last nine months of 1957.

#### EXCHANGE RATES

American-account sterling tended to ease during November, declining from a high of  $\$2.80\frac{13}{16}$  to a low of  $\$2.80\frac{3}{8}$ . The quotation moved lower—whenever commercial demand in New York subsided or the demand for dollars increased in London—until midmonth, when good commercial demand developed for sterling, particularly from oil and diamond interests. Following the reduction of the British bank rate on November 20 from  $4\frac{1}{2}$  to 4 per cent, the quotation moved gradually lower and, possibly influenced by international political developments, declined to the month's low near the end of the month. On November 28 it closed at  $\$2.80\frac{7}{16}$ .

In the forward market, substantial demand from cotton interests and anticipation of a reduction in the British bank rate, about midmonth, resulted in an appreciable narrowing of the discounts on three and six months' deliveries, which had been holding at about  $2\frac{3}{32}$  cent and  $1\frac{1}{8}$  cents. When the reduction in the bank rate materialized on November 20, the discounts narrowed further, and by the month end they were  $\frac{9}{32}$  cent and  $\frac{5}{8}$  cent, equivalent to 0.402 and 0.446 per cent per annum, respectively.

Transferable sterling rose from  $\$2.79\frac{7}{32}$  at the beginning of November to  $\$2.79\frac{21}{32}$  on November 17—the highest rate since May—on demand from the Continent and from sugar interests in New York as well as recurrent rumors of a consolidation of transferable and American-account sterling. Thereafter, the rate moved lower, primarily on Swiss offerings, to  $\$2.79\frac{1}{4}$  on November 24 but closed the month at  $\$2.79\frac{17}{32}$ . Securities sterling advanced from  $\$2.78\frac{5}{8}$  to  $\$2.79\frac{3}{8}$  during November, on demand associated with interest in certain London stocks, and on November 28 stood at  $\$2.79\frac{1}{8}$ .

The Canadian dollar moved erratically between  $\$1.03\frac{5}{64}$  and  $\$1.03\frac{21}{32}$  during the month. Following a period of relative inactivity in the earlier part of the month, the rate advanced to the higher level on November 21 in an active market, reflecting a combination of investment demand and of developing commercial demand—in part from grain houses and paper companies. The November 28 closing quotation was  $\$1.03\frac{1}{2}$ .



# **International Liquidity**

*by Dr. Per Jacobsson, Managing Director,  
International Monetary Fund*

**FEDERAL RESERVE BANK OF NEW YORK**

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**SUPPLEMENT TO**

**MONTHLY REVIEW, DECEMBER 1958**

## International Liquidity\*

*by Dr. Per Jacobsson, Managing Director, International Monetary Fund*

As we all know, a great deal has been spoken and written recently about the problem of international liquidity; and it is therefore not surprising that I have been asked to speak on this subject at the present meeting of your Association. A year ago when the economic recession became more in evidence here in this country, there were, of course, those who remembered, especially in Europe, how many learned economists, and others also, had been convinced that a setback in the American economy would expose other countries to a strain in their balance of payments and, indeed, intensify what had been called "the dollar shortage". For the European countries this could be a serious matter; a number of them had already experienced two periods of acute tension in their exchange markets since the summer of 1956, and if they now had to look forward to another period of exchange troubles, they were naturally inclined to be worried. The British especially, who had been taking strict measures at home to restore their financial position, began to be anxious, and they considered it necessary to enter into discussions with their American friends about the international liquidity position, with a view to finding out whether some safeguarding measures could not usefully be taken.

Looking back, we now know that the movements in the exchange markets have been very different to what had been feared; instead of losing reserves to the United States, most European countries, and also some countries outside Europe—notably Japan—have been able to increase their gold and dollar holdings quite substantially, while the United States on the contrary has had to sustain a gold outflow of about \$2 billion. Fortunately the United States has still very large gold reserves, and with other industrialized countries gaining reserves, there are not at the moment any signs of an immediate liquidity crisis or any real prospect of any such crisis in the foreseeable future. I think it is fair to say that, at the recent meeting of the Fund and the Bank in New Delhi, the representatives of the industrialized countries in Europe and elsewhere were more relaxed than they had been at any previous meeting of these two institutions. But even so, the discussion about the world's liquidity position has been continued; and—what is really significant—at the New Delhi meeting

the representative of the United States put forward proposals for an increase in the resources of the Fund and the Bank. Why have these proposals been made? And why is it that these proposals have received almost universal approval at a time when nobody seems seriously to believe in any immediate threat to the world's liquidity position?

Before I try to answer these questions, let me for a moment recall how the problems of international liquidity were successfully dealt with in the days before 1914, when almost all countries adhered to the rules of the international gold standard. The gold standard system as it worked before 1914 secured for the world the following two advantages:

In the first place it was effective in maintaining proper balance between the economies of the various countries. If in the pursuit of too lax a credit policy a particular country went out of line it would lose gold; and it was then bound by the generally accepted rules to increase its discount rates and to take other restrictive measures to check or reverse the flow of gold. Since world trade was generally expanding, it was often sufficient for a country to call a halt in the credit expansion to get into line again. The measures were no doubt harsh at times but, since world trade was expanding, they generally did not cause more than passing hardships.

Secondly, the regular flow of gold from current production led to a general increase in monetary reserves, which in its turn gave an impetus to expansion in the supply of credit, sufficient as a rule to provide the increase in purchasing power and working capital needed to finance the growth in trade and production. The Swedish economist, Professor Gustav Cassel, laid great stress on the role that newly mined gold played in securing an adequate expansion in the financial structure; he arrived at the famous figure of 3 per cent as the rate of expansion required. In some periods before 1914 this rate was not fully reached, in other periods it was somewhat exceeded, but the divergence was never considerable, with the result that the general price level was relatively stable in the period 1860 to 1914.

If we take a look at the reserve holdings of the individual countries, we find that some had quite substantial gold reserves which went on increasing from year to year; others—particularly Great Britain—had what we would now consider astonishingly slender gold reserves—only some £30 million or \$150 million when they were the

\* Because of the importance and timeliness of this subject, and the unique qualifications of the writer, the Federal Reserve Bank of New York has invited Dr. Jacobsson to prepare, as a Supplement to the Bank's *Monthly Review*, this slightly expanded version of an address which he delivered at a joint meeting of the New York Division of the American Finance Association and of the Metropolitan Economic Association on November 14, 1958.

highest for any pre-1914 year. One reason why London, although the centre of the pre-1914 gold standard system, could manage to maintain orderly monetary conditions on such a slender gold basis was that Great Britain at the time was a pronounced creditor country and more precisely had substantial short-term claims on other countries—largely in the form of acceptances—which could readily be mobilized. Another reason was the effectiveness of the British banking system, working with a traditional 10 per cent cash ratio; in such a system only a relatively slight addition to reserves was needed for credit to be expanded in an effective way. As between the individual countries the proportion between the gold reserve, on the one hand, and the credit volume or the volume of foreign trade, on the other hand, thus varied considerably. Both for the individual countries and for the community of nations the efficient working of the credit system was a factor of the greatest importance. Just as the liquidity of an individual firm can never be judged on its cash holdings alone, since account must be taken of its credit standing and its borrowing possibilities, so the very fact that the international credit system functioned smoothly under conditions of widespread monetary confidence made it possible as a rule for individual countries to borrow when a deficit arose in the balance of payments, so that they would not have to rely solely on their reserves at a period of strain. There would often be an equilibrating flow of funds in response to even slight variations in interest rates and in the quotations in the foreign exchange markets—a form of “borrowing” inherent in the system itself. In the efforts to restore and maintain balance, the tasks of the central bank can be much facilitated by such movements of privately owned funds.

There are indeed three main lessons still valid to be learnt from the working of the pre-1914 gold standard: there is need for monetary discipline to keep the various economies in balance one with the other; there must further be a mechanism sufficiently effective to assure the expansion in the credit supply needed to sustain the growth in trade and production; and, thirdly, in order to implement these prerequisites and thus to assure a properly functioning international monetary standard there must be an effective international credit system.

Indeed, foreign as well as domestic trade is financed primarily by commercial banks and it is the supply of commercial credits that keeps the wheels of commerce moving. The liquidity generated in the financially important countries is therefore of special importance for the trend of world trade—to give but one example—and an example from our day—the credit expansion in the United States during the recent recession has helped to increase the supply of dollars also to the rest of the world and has thus facilitated international settlements. But in order to

expand credit, the commercial banks need the support of the central banks—here in the United States of the Federal Reserve System—and such support can only be granted if the central banks themselves are in a sufficiently strong position. Situations may arise—in emergencies, in booms and in depressions—when the central banks are in need of temporary assistance—and the need of such assistance was, of course, one of the main reasons why the Bretton Woods institutions and especially the International Monetary Fund were established.

Before I turn to the consideration of the problems that now beset us there is one important phase of the interwar period from which, I think, we still have a lot to learn. I refer to the phase which led up to and followed the suspension of gold payments by the Bank of England in September 1931. I suppose some of you would still remember how in May of that year the largest Viennese bank—the Austrian Credit Anstalt—had to close its doors; how the nervousness which this created spread to Germany and gave rise in the summer to a very severe banking crisis in that country; how then within a few weeks the pound came under pressure and the flight of capital became so intense that, in September, first the pound and then a number of other currencies were devalued. Thus a crack which had begun in a relatively small country went on spreading; and before the disruption was ended, both the dollar and the so-called gold bloc currencies—including the Swiss franc—had also to be devalued. There are a few observations which I would like to make in this connection.

It is often asserted that the real reason for the devaluation of the pound was that the British authorities had in 1925 stabilized their currency at too high a level, namely the pre-1914 gold parity—so that it necessarily had to be adjusted in relation to other currencies. But when the whole process of adjustment was over, by the middle of the 1930's, the pound and the dollar as well as most other currencies had again reached very much the same relation to each other as existed before the devaluations, so in that respect hardly any real change had occurred. Would it not then have been better if the original relationship had been preserved? After all, little was gained for the world by these devaluations: world trade remained stagnant throughout the 1930's, notwithstanding the resort to cheap money policies and deficit spending pursued in so many countries.

In fact, some serious efforts were made in 1931 to support the existing exchange structure when it came under pressure. Special credits were arranged up to a total of about Swiss francs 5 billion or \$1 billion which in real value would be equal to at least \$2.5 billion today. These credits, as we know, proved insufficient but this does not mean that a larger amount of credit, perhaps twice as

much, would not have been successful in averting the devaluations—and in doing so many of the subsequent troubles, political as well as economic, might well have been averted.

Winston Churchill has said about the Second World War that it was the most unnecessary war in the history of mankind. I would not go so far as to say exactly the same about the devaluations of 1931 and the following years but I still think they could have been avoided: and if they had been avoided, much of the trouble that followed in their wake would also have been avoided and perhaps even the war itself.

I have dwelt at some length on this liquidity crisis of 1931 because I am haunted by Santayana's saying: "Those who do not remember the past will be condemned to repeat it."

After the gold standard had broken down in the interwar period, something new and more firmly founded had to be built and that was the task at Bretton Woods. The International Monetary Fund in particular was established to ensure a better order in monetary relations and to do that by granting, in case of need, financial assistance which would help the particular countries to take the proper steps to restore balance both internally and on their foreign accounts. It was, however, specifically laid down that the Fund was not intended to provide facilities for postwar reconstruction or relief. Nevertheless, thanks to Marshall Aid and the fact that many overseas countries had fairly large sterling and dollar balances accumulated during the war, it was possible to embark upon programs of postwar reconstruction without being unduly hampered by a dangerous shortage of foreign exchange. Since these needs were thus met from other sources, there was little necessity for Fund assistance in those years.

The combination during the war years of direct controls to keep down prices and the generally rapid rate of increase in the volume of money and of claims that could easily be turned into money left most countries with excess liquidity in their domestic markets in the postwar period of reconstruction. This excess liquidity necessitated some important adjustments, which for the most part took the form of a fairly rapid increase in prices, although in a number of countries the adjustments also took the form of devaluations. Often one crisis followed the other—notwithstanding the aid from abroad—but after ten years of postwar reconstruction, two important results had undoubtedly been gained: (i) By 1956 the European economies had generally reached a fair degree of balance internally and in relation to each other and to the rest of the world; (ii) by that time the adoption of flexible credit policies (including changes in interest rates) had generally been accepted as an essential element in the efforts to maintain a balanced position.

Both these gains were put to a severe test at the time of the Suez crisis that occurred in the autumn of 1956, which, in particular, exposed the pound sterling to a considerable strain. The pound being a currency used for international settlements was particularly vulnerable in a period of nervousness; those who had claims on London asked for immediate payment, while those who had payments to make in sterling delayed as long as they could the date of settlement. Britain's gold and dollar reserves were rapidly reduced by these capital movements, although the current account of the balance of payments continued to show a surplus. In December, the British Government turned to the Fund with a request for financial assistance for an amount of \$1,300 million, and received a drawing of \$561 million, and a stand-by of \$739 million. Moreover, a line of credit of \$500 million was arranged with the Export-Import Bank. The assistance by the Fund was granted on the basis of a declaration by the British Government that strict financial and credit policies would be pursued; that quantitative restrictions would not be reimposed; and that the value of the pound sterling would be maintained. Thanks to the policies thus pursued, and the financial assistance obtained, the crisis was averted and the value of the pound upheld.

Nervousness persisted however. In the summer of 1957 a new tension set in on the European exchange markets—this time caused more particularly by rumors regarding a possible revaluation of the German mark. In September 1957, when the crisis was at its height, the Bank of England raised its discount rate from 5 to 7 per cent, while the Deutsche Bundesbank lowered its rate from 4½ to 4 per cent, and declarations were made at the Fund meeting in Washington to the effect that there was no intention to alter existing exchange parities. These measures and declarations impressed the markets, calm being restored; from October 1957 up to the present—for thirteen consecutive months—Great Britain has been able to add to its reserves. All this points to the fact that the pound was not overvalued; that there was no fundamental reason for any devaluation; that it certainly was in the general interest that the exchange crisis should be overcome. For had it led, as happened in 1931, to an alteration in exchange value, nobody could have told what the consequences might have been.

At the time of the Suez crisis the Fund was able to grant substantial assistance to Great Britain because its holdings of gold and convertible currencies were at that time still almost intact. This was, however, the beginning of a very active period for the Fund, and the assistance granted has reduced its uncommitted resources so that today it would not again be possible to extend assistance on such a massive scale as was received by Great Britain.

So, when I now turn to the question of increasing the

resources of the Fund, one of the principal reasons for such an increase—but by no means the only one—is to be found in the general interest of avoiding devaluations which are not dictated by the realities of foreign trade and competitive prices, since experience shows that once a crack starts it is difficult to limit its effects. However, in this connection, it is important to remember that the British Government itself took very strict measures, including an increase in Bank rate, to 7 per cent—which is an unusually high rate in times of peace. In other cases where the Fund has granted financial assistance corrective measures have also been taken by the countries which received the assistance; and the policies which the countries in question intend to follow have been set down in declarations to the Fund, often taking the form of comprehensive stabilization programs, as recently in the case of France, Brazil, and Turkey. In these and in some other cases, the resources which the Fund has provided for the support of their programs have been supplemented by credit facilities obtained from other sources—from United States agencies, the European Payments Union and, in a few cases, also from New York banks.

The principles and practices which govern the granting of financial assistance from the Fund had already been laid down by the Board of Executive Directors before the active period started in 1956. The attitude of the Fund towards requests for drawings or stand-by arrangements depends not upon the absolute amount involved, but upon the proportion it bears to the country's quota (each country has a quota in the Fund which determines not only its contribution to the Fund but also its voting power and its possibilities of obtaining assistance). Requests for drawings of the first 25 per cent of the quota, normally corresponding to the country's own gold subscription, are almost automatically approved; for the next 25 per cent the Fund's attitude is a liberal one—the members being required to show that they are making reasonable efforts to solve their own problems. For any drawings beyond these limits, however, substantial justification is required: namely, that the drawing must be in support of a sound program likely to ensure enduring stability at realistic rates of exchange. It is largely through the application of these principles that the Fund is able to contribute to the observance of a degree of monetary discipline in the member countries. The Fund is not therefore just an additional source of credit, but is recognized more and more as a source of credit that is available in substantial amounts only to member governments that have satisfied the Fund of their intention and capacity to restore balance. These principles apply to developed and underdeveloped countries alike; in fact, the majority of cases in which the fund has granted assistance has been in relation to underdeveloped countries, which have had to satisfy the Fund as well as the other institu-

tions from which they have requested assistance as to the soundness of their programs. I believe that with the enlargement of the Fund's resources there is no desire or intention to depart from the principles which have thus been laid down.

There are indeed some strong arguments for contributing to an increase in world liquidity by means of an increase in the Fund's resources. Through the financial assistance the amounts made available by the Fund are pinpointed to particularly weak spots in the monetary structure, and are thus used to prevent cracks.

Secondly, the funds are made available at a time when they are most needed—which may be in times of boom as well as in times of depression. As a matter of fact, the greatest amount of Fund assistance was made available in the boom years of 1956-57. Some Fund assistance has also been granted in the recession, but perhaps less than had been expected. It would, however, be rash to conclude that the Fund will never in the future be called upon to grant large-scale assistance when business activity declines. This time the flow of funds has been decisively influenced by the credit expansion and the fairly liberal trade policies in the United States. But even if such policies are pursued when a United States recession again sets in, one can never tell what other factors may be operating. The Fund must in fact be prepared as it has been in the past for diverse contingencies—many of which cannot be clearly defined in advance.

Thirdly, the Fund will help to ensure that degree of financial discipline, without which no international monetary standard can function properly. This is the more important, since the quasi-universal adherence to the fairly simple rules of the old gold standard is now a thing of the past. These rules served the world quite well in the years before 1914, providing a basis for an increase in production and trade, and in living standards, beyond anything known up to that time. Then in the 1930's this system received a deadly blow, not merely through the devaluations but more particularly because the hardships were no longer temporary but in fact seemed interminable and the idea spread that the gold standard set of rules could no longer work. It is true that in recent years flexible credit policies have again been adopted, and generally more attention is being paid to monetary stability, but that does not mean that the earlier rules are again thought to be fully applicable. For one thing, the public sector is now more extensive than it was in the past; now amounting in most countries to some 25 per cent or more of the gross national product, as compared with less than 10 per cent before 1914—and this in itself makes it necessary for conscious monetary management to play a greater role, whether we like it or not. More time is generally required for corrective measures to take effect, and to gain that time

financial assistance may often be needed to supplement reserves. Without the corrective measures, assistance will, however, be of little avail. The Fund system establishes a combination of financial assistance and corrective measures in conformity with the principles just described, and this combination has to a large extent already been tried out in practice. It should be possible for this new system to gain widespread allegiance, and in that way help to restore that measure of discipline without which the world cannot expect to reap the benefits of a properly working international monetary standard.

May I add some further considerations which argue in favor of an increase in the Fund's resources? The balance which has been restored by the economies of various countries, taken together with the recent improvement in the reserves of most industrialized countries, has naturally again raised the question whether some further steps could not be taken in the fairly near future to restore the convertibility of currencies, at least of the leading countries. The possibility of having recourse to the Fund's resources—as a second line of defense—may make countries more confident to make progress towards convertibility, and may, indeed, induce them to take stricter and more constructive measures than if they had to rely on their own resources alone. At the New Delhi Conference, the British Chancellor of the Exchequer, Derick Heathcoat Amory, stated at the Fund meeting that the strengthening of sterling had “brought us still nearer to the convertibility of the pound, which is our objective”.

It should, however, be pointed out that it is not only the countries approaching a state of convertibility that benefit from the possible access to the Fund's resources, but other countries also—and especially those which seek, as many of them do, to liberalize their trade at more realistic rates of exchange. When these countries proceed to restore internal balance as a prerequisite for further progress, they, too, can act more courageously in the knowledge that there is the possibility of Fund assistance as a second line of defense.

Secondly, it is an important fact that the world's trade has risen considerably in volume and value in the postwar period, with the result that whenever periods of nervousness set in very considerable shifts may occur in the timing of the payments between the various countries; therefore, in any emergency, or even in any period of exchange tension, the movements of funds that will follow are likely to be on a large scale. The rise in prices by at least 50 per cent since 1946 has reduced the real value of the Fund's resources, which are now considerably less than was envisaged when the original endowment was made. In fact, an increase in these resources by 50 per cent would merely give to the Fund the same power of action that was allotted to it at Bretton Woods. At the moment the Fund's

uncommitted resources in gold and United States dollars amount to \$1.4 billion. By an increase of 50 per cent in the quotas the Fund would obtain an additional amount in gold and United States dollars of about \$2 billion; it also seems likely that drawings of some of the major currencies which are not yet fully convertible will become increasingly attractive to members. Thirdly, I should like to emphasize that the Fund's ability to provide resources to countries in difficulties benefits not just those countries which have sought or may seek the Fund's assistance but all the members of the Fund. This will be true in the future as it has been in the past. It was, for example, in the general interest that a devaluation of the pound sterling was avoided in 1956, that tension in the exchange markets was reduced in 1957, and that countries have been helped to push forward with their stabilization programs; it is also in the general interest that by means of a stricter observance of financial discipline a sound monetary basis should be created for a renewed expansion of world trade.

Now I can imagine that somebody might say that, although an increase in the Fund's resources is all to the good, there still remains the problem of providing the regular increase in liquidity required for an expanding world trade. It has already been said above that commercial banks to be able to increase their financing will have to be supported by the central banks, but that these central banks will be in a position to give that support only if they themselves are in a strong position. The question may well be asked whether it is not then necessary to ensure a regular increase from year to year in the reserves of the central banks, and is it not true to say that the Fund cannot contribute to any such sustained increase in reserves, since its assistance is only of a short-term character—being repayable within three to five years? Would it not be better—it has further been asked—to raise the gold price so that more substantial contributions could be obtained from the current output of gold?

These are important questions, and I could only wish that I had more time to devote to them. The staff of the Fund has this summer published a document entitled “International Reserves and Liquidity” in which these problems are fully discussed. Here I can only make a few brief remarks.

Those who advocate an increase in the gold price generally take as a starting point a particular year in the past, say the year 1938, when the relation of reserves to world trade was exceptionally high, and they then contend that a similar relation should be restored without much delay.

But 1938 was a year of stagnant trade in a disturbed world, with a most lopsided distribution of reserves caused largely by the massive flights of capital from war-scared Europe to the United States. For these and other reasons, 1938 is a most unsuitable year as a basis for comparison.



If 1913 or 1928 had been selected instead, the present reserve position would appear in a much more favorable light. But so many other factors have to be taken into account—among them the proper working of the international credit system—that no year in the past can really be said to provide an appropriate basis for the purpose of comparisons in this field.

Another line of argument has been that, since world trade may be expected to rise by something like 3 per cent a year, central banks ought to increase their reserves by 3 per cent a year also. But such a projection presupposes that those countries which already have large reserves should also continue to increase them at this rate. We find, however, that in general many of these countries consider that they already possess all the reserves they need to give adequate support to their commercial banks, and to meet whatever deficits may arise in their balance of payments. I am told that neither Switzerland nor Western Germany want to add at all to their present reserves—and I believe the same applies to Venezuela—while the United States is still the owner of over one half of the Free World's stock of monetary gold. If one limits the consideration to the other countries which have not such large reserves, one finds that an increase at the rate of 3 per cent per year would, over the next ten years, require an addition to reserves of about \$8 billion. On the other hand, we find that the addition to reserves from current gold production is likely at the present price of gold to be at least \$7 billion for the next decade, even after allowing for an increase in the present large gold hoards. Thus gold production as a whole will go far towards meeting the additional requirements of reserves, and some further addition may be expected from increased dollar and sterling holdings of many countries. Moreover, the likelihood is that some of the countries which ought to add to their reserves will not in fact do so, and the result is therefore likely to be that at least some of the newly mined gold will probably be diverted to countries which already have sufficient reserves.

If the gold price were nevertheless to be raised and the annual supply of newly mined gold becoming available for monetary purposes thus to be increased by added value and rising output from \$700 million to, say, \$1,400 million a year the result might well be that too much gold would be offered to the monetary authorities. One must not forget that liquidity can be excessive, giving rise to further inflation if costly and difficult countervailing measures are not taken. It may well be held that gold will retain its usefulness as a currency basis (and not lose it like silver did) only if it remains sufficiently scarce to be well sought after and willingly absorbed.

I mentioned at the beginning of this discussion that in

the days of the old gold standard before 1914, the British banking system was able to expand credit sufficiently on a relatively slender gold basis. Now that the leading countries have relatively ample gold and foreign exchange reserves—especially after the recent improvement in the British position—it would seem that the credit volume in these countries could be expanded sufficiently to meet the normal needs of a dynamic world economy without any of them being unduly hampered by reserve considerations. Although there is therefore little reason to worry about the over-all reserve position of the world, safeguards must nevertheless be provided for exceptional circumstances of an emergency nature, for assistance in the implementation of stabilization programs, and for some other purposes—requirements which may be met by resort in case of need to the resources of an enlarged Fund. If these safeguards are provided, the basis should have been established for the pursuit of intelligent credit policies under which sufficient liquidity can be generated to keep pace with, and even to stimulate, the growth of world trade. These are developments which are important even in a much wider field for they form a prerequisite for more confident long-term investments, and for the pursuit of all those other activities which help to build up a sound world economy.

Before I finish I should like to point out that the Free World's record in the financial field has been far from unsatisfactory in recent years. There have been formidable difficulties to be overcome, of both a political and an economic nature, but what have the results been? The emergency after the Suez crisis was successfully mastered, and so was the tension on the exchange markets which became so acute in the summer of 1957. There is now more confidence in most currencies than there was only a few years ago. Moreover, the recession here in this country has once again been only of short duration. World trade has not generally been hampered by new obstacles in the form of increased tariffs or import restrictions, but showed considerable resilience in the face of a downward trend of business. Foreign aid has been continued, and efforts have been made by the Fund and others to extend financial assistance to countries in temporary difficulties, not only to permit corrective measures to take effect but also to enable them to continue their development. All this has very largely reflected sound judgment and courageous action on the part of the authorities in many countries of the Free World. And it is, of course, in the interest of us all that the progress made should be consolidated and expansion resumed. I think we may regard the proposals to increase the resources of the Fund and Bank as a further sign of willingness and determination to give added strength to the economies of the Free World.



## Recent Economic Developments in West Germany

Over the past decade, the Federal Republic of Germany has re-emerged as one of the great industrial nations of the world. The upsurge in domestic economic activity and the rebuilding of the country's international position have been virtually uninterrupted since the 1948 currency reform. Gross national product has increased at an average annual rate of about 8 per cent in real terms, and industrial production by more than 10 per cent. During this same period, exports have expanded nearly ninefold and German gold and foreign-exchange reserves have risen to \$6 billion, the largest holdings of any foreign country.

This remarkable performance owes much, of course, to such special factors as United States and other Allied aid and the absence until very recently of any arms burden on the German economy. But fundamentally Germany's progress reflects, on the one hand, such broader human elements as hard work and a willingness to accept a relatively low level of consumption and, on the other hand, policy decisions such as the adoption of a tax structure relatively favorable to savings and investment and the determination to return to a free market and free enterprise system. Perhaps the brightest aspect of recent German economic developments is the impressive strengthening of the country's international position, which has turned the German mark into one of the hardest Western European currencies. This achievement reflects to a large extent the monetary policies pursued by the German central bank, which generally has placed strong emphasis on price stability and the external value of the currency and has abstained from measures that would stimulate domestic demand at the cost of inflation.

The German economy, however, has also had to face some major problems. Two of the more important ones have been the impact on Germany's trade partners of the continued accumulation of international reserves, and the narrowness of the capital market. The absence, at least until recently, of a genuine and smoothly functioning capital market has stemmed largely from the disorganization of the country's financial structure as a result of the war and its aftermath and from the sheer magnitude of postwar capital requirements.

During 1958, marked by recession elsewhere, German economic activity continued to grow and both output and exports advanced, though at a considerably slower pace than earlier. The German economy has in fact shown general immunity to the decline in activity in other industrial countries, and to the often serious payments difficul-

ties of some of its customers in underdeveloped areas. This is not to say that the German economic scene is uniformly bright. On balance, however, the expansionary factors appear to predominate over the contractive ones.

### CONTINUED EXPANSION OF ECONOMIC ACTIVITY

This year, when economic activity on many other Western European countries ceased to grow or actually declined, the German economy was able to show further, albeit moderate, gains. During the first half, the German gross national product increased at an annual rate of some 2.5 per cent in real terms; since some acceleration is expected in the second half, its growth may well reach 3 per cent for the year as a whole. While such an increase compares rather unfavorably with recent years, there is every indication that this year's modest, but still comfortable, rate of advance will be maintained in 1959. The growth this year appears to have been sustained primarily by an upsurge in home building and public construction, by higher personal consumption expenditures (the result in part of increases in wages and government salaries and of income tax reductions), and to a smaller degree by the continued rise in exports of goods and services. Fixed business investment, on the other hand, has remained at last year's level, while inventories have been drawn down, following the substantial build-up of recent years.

Industrial production, too, is expected to show an increase of some 3 per cent this year. Except for May, when it dipped sharply, output exceeded the corresponding 1957 level in every month. Sectors that have made a particularly strong showing this year include the automobile, chemical, electrical equipment, oil, and natural gas industries; the automobile industry alone has more than tripled its output since 1950. In addition to these industrial sectors, construction activity has shown a forceful upward trend—fostered in part by a substantial decline in interest rates—and is considered a major prop of over-all activity this year.

Marked declines, on the other hand, have characterized three major industries. In the iron and steel industry, lower consumption as well as inventory liquidation by domestic steel users reduced output by October to 80 per cent of the postwar peak reached in November 1957. The coal industry has also had to contend with reduced domestic demand, partly because of lower activity in the steel industry but more basically because of a gradual

shift to fuel oil for industrial and residential use. The textile industry similarly has faced a decline in sales which, aside from competition by cheaper imports, appears to reflect a fundamental structural change in consumer demand. As clothing and furnishing deficiencies inherited from the war and the immediate postwar years have come to be satisfied, rising incomes and higher living standards have turned consumer spending increasingly to durable goods, such as motor vehicles and household appliances, as well as to travel and other service expenditures.

Although the steel, coal, and textile industries together employ over 5 per cent of the total labor force, their difficulties have not seriously affected the over-all employment situation. In fact, unemployment, mainly under the impact of unusually strong seasonal activity in the construction industry, fell by the end of September to an all-time low of 328,000, or to only 1.7 per cent of the labor force, from 2.3 per cent in mid-1957. Finally, the pleasing picture of continued, even if slower, expansion in economic activity and of full employment is rounded out by a definite slowing-down in the domestic price rise—partly under the influence of lower world commodity prices, lower ocean freight rates, and bountiful domestic harvests. The relative stability of prices also undoubtedly owes much to increased productivity, which appears to have offset a large part of the wage increases granted this year.

#### INTERNATIONAL POSITION REMAINS STRONG

While total world exports during the first half of 1958 were some 6 to 7 per cent lower than a year earlier, German exports continued to rise—although considerably more slowly than in recent years—and thus contributed, as in previous years, to the expansion in domestic economic activity. Foreign orders for German exports, which already had declined during 1957, have remained generally below last year's level, falling to as much as 6 per cent below actual deliveries. However, aside from the backlog of earlier orders, there were several additional factors that have tended to sustain exports. Shipments of capital goods to underdeveloped countries have been largely unaffected by the import cutbacks imposed by these countries as a result of their own payments difficulties. Moreover, there are indications that the growth in German exports has been facilitated by lengthened payments terms extended by German suppliers, in turn a reflection of the sharp decline of interest rates in Germany. Exports during the first nine months of the year thus were some 2.6 per cent higher, in both value and volume, than in January-September 1957.

While total exports continued to advance, the fall in

world commodity prices and in ocean freight rates has resulted in an import bill for January-September 1958 that was 2.2 per cent below a year previous, despite an increase of some 6 per cent in the physical volume of imports. Imports of finished manufactures increased sharply, stimulated in part by tariff reductions, and the decline in import value fell primarily on raw materials. With a large part of these imports coming from the dollar area, the over-all import decline was reflected mainly in sharply lower dollar imports (especially of wheat, coal, and cotton).

As a result of these developments, Germany's January-September trade surplus amounted to \$1.0 billion equivalent as against \$0.7 billion in the first nine months of 1957. Yet despite the increased trade surplus (and a parallel, although substantially smaller, rise in the surplus on current account),<sup>1</sup> Germany's international reserves have grown much less sharply this year than in either 1957 or 1956. During the first ten months, official gold and foreign-exchange holdings increased by \$585 million equivalent, to a total of \$6,000 million; this gain compares with increases of \$1,375 million and of \$1,040 million in the first ten months of 1957 and 1956. The smaller growth in reserves this year is partly attributable to the absence of speculation over a possible revaluation of the German mark. More fundamentally, however, the smaller gain in reserves reflects the steady increase in the outflow of capital, which more than offset the rise in the surplus from trade and service transactions.

Aside from indemnification payments and the amortization of external debt obligations, the bulk of the capital outflow from Germany in the past few years has been in the form of official capital exports by the German central bank. These capital movements have almost exclusively taken the form of subscriptions and contributions to, as well as credits extended jointly with, international financial institutions such as the International Bank, the International Monetary Fund, and the European Payments Union. This year such official capital exports have been responsible for the bulk of the increase in the over-all capital outflow; they have included the payment of the initial instalments of the subscription to the capital of the European Investment Bank, as well as German participation in the joint credit extended to France in January by the European Payments Union, the International Monetary Fund, and the United States, and the German share in the assistance to Turkey announced last July. Thus Germany has been making a contribution to a better distribution of international reserves.

<sup>1</sup> The surplus on service transactions has generally been smaller this year, mainly because of a sharp spurt in foreign travel by German nationals, which this summer produced the first deficit on tourist account in the postwar period.

There has also been some increase in private long-term capital export, though not on a large scale. Direct investment abroad by German industry and trade financing by German exporters have been increasing in recent years, and the placement of private short-term funds abroad was resumed in late 1957. Moreover, a modest but encouraging beginning in the direction of long-term borrowing by foreigners in Germany was made last September when the Anglo-American Corporation of South Africa raised DM50 million (\$11.9 million equivalent) on the German capital market, the first foreign industrial bond issue to be placed in Germany since 1914.

#### TOWARD A VIABLE CAPITAL MARKET

The German authorities have welcomed the export of capital in collaboration with international financial institutions. The feeling appears to prevail that loan assistance to underdeveloped countries or to countries in temporary financial difficulties should be given as much as possible through these institutions—not only because such transactions would fit closely into the concept of a multilateral trade and payments system, to which Germany subscribes, but also because these institutions are able to supervise more closely the use of the funds by the borrower. At the same time, the authorities are aware of the limitations to official capital exports and are looking forward to the day when foreign lending by Germany need no longer lean on the crutch of the government or the central bank, but can instead be provided via the capital market and direct foreign investment.

At the moment, there are indications that the German capital market has recovered sufficiently from its postwar difficulties to begin to fill this role.<sup>2</sup> The above-noted placing of the South African industrial issue in September, with a 5½ per cent coupon and at par, would not have been possible without the substantial decline in long-term rates that has occurred during the past fifteen months. In fact, it is only during the past two years, when industrial borrowers have come to the fore again, that it has been possible to regard the long-term rate as a true market barometer. During 1953-54, capital market activity was distorted by the full tax exemption on income from housing bonds and most public issues, while from the fall of 1955 through mid-1956 the flow of funds into the market virtually ceased. The re-emergence of a meaningful long-term interest rate dates back to an industrial issue with an 8 per cent coupon, offered in July 1956 at 98, after a lengthy interval during which private nonbank borrowers

had shunned the market altogether. In July 1957 the first industrial issue with an effective yield below 8 per cent was floated. Since then, offerings by all categories of borrowers—industry, municipalities, mortgage banks, and public authorities—have been placed at successively lower effective yields; this downward movement eventuated in an issue of the German Federal Railways in October of this year, priced to yield slightly over 5.5 per cent. Simultaneously, the prices of outstanding issues have been bid up, with corresponding sharp declines in yields. It is noteworthy, moreover, that this plummeting of the effective yield was accompanied by a swelling volume of new bond issues.

The authorities have attempted in various ways to contribute to greater viability of the capital market. One obstacle to the channeling of a larger volume of funds into that market was presented by the attractive rates being paid on the various types of bank deposits, which in 1956 ran as high as 5½ per cent on certain categories of time and savings deposits. These high rates tended to keep substantial amounts of funds, as German financial writers have put it, in the “outer courtyards” of the capital market. President Blessing of the German Federal Bank, upon his assumption of office last January, remarked that the prevailing liquidity of the German money market was favorable to a further broadening and strengthening of the capital market, a trend that he said should be supported by the central bank’s interest rate policy. In fact, the desire to make a contribution to the development of the capital market influenced the German Federal Bank’s decision to lower the discount rate from 4 per cent to 3½ last January. Similar interest rate considerations underlay in part the further lowering of the discount rate to 3 per cent in June; this move was followed the next month by reductions of up to ⅞ per cent in the rates paid by the banking system on savings and time deposits. Rates on time deposits and on certain savings deposits were reduced further in mid-November, with the result that rates now range from 2 to 3½ per cent for time deposits and from 3 to 4 per cent for savings deposits.

As a further stimulus to the securities market in general, a number of sweeping tax reforms were adopted on April 1, most of which were made retroactive to January 1. These measures included a reduction in the corporate tax on distributed profits, a simultaneous increase of the tax on undistributed profits, and a number of incentives to savings, such as tax reductions on the income from stocks, bonds, and investment trust certificates held for five years.

But aside from these official proddings, there have been a number of factors that have tended to bring about the present revival of the German capital market. On the sup-

<sup>2</sup> For a fuller discussion of German capital market problems during the postwar period, see “The Revival of the German Capital Market”, *Monthly Review*, September 1955.

ply side, there has been a marked increase in personal savings, which in turn has led savings banks, mortgage banks, and other financial institutions to add considerably to their securities portfolios. On the demand side, the relatively slower pace of economic activity, the intermittent abstinence from the market by potential borrowers in the expectation of further declines in interest costs, and the complete absence of borrowing by the federal government have contributed to the revival.

### CONCLUSION

The continued expansion of German economic activity undoubtedly has provided a measure of support to the international economy during the past twelve to fifteen months. It is true, of course, that a certain slowing-down in that expansion has occurred. The present phase, how-

ever, is regarded in many quarters as a needed breathing space or a period of consolidation, following the rapid strides of the German economy since the currency reform of 1948. At the same time, progress has been made toward integrating Germany more fully into the international payments system. The president of the German Federal Bank pointed out at the New Delhi meeting of the Bretton Woods institutions in October that the German authorities are conscious of the responsibilities of German economic policy with regard to international economic equilibrium. With domestic economic stability ensured, it is now perhaps possible to tackle the problem of Germany's large international surpluses. The recent decline in German interest rates and the attendant narrowing of the yield differential between the German and other capital markets represents an auspicious beginning in that direction.

## The Federal Home Loan Bank System

When the Federal Home Loan Bank System was first established in 1932, its primary function was to rescue distressed home financing institutions by providing a central reservoir of credit. But even then it was anticipated that the FHLBS would develop into an institution which would facilitate the flow of funds to the mortgage market under more normal circumstances. That this has indeed occurred is amply demonstrated by the important role the FHLBS has played in the housing boom of the postwar period, when member lending institutions smoothly accomplished a nearly fivefold expansion of their mortgage holdings with no weakening in the quality of the assets or safety of the institutions involved.

Savings and loan associations are by far the most important group among the 4,501 member institutions of the FHLBS; the membership includes twenty-four savings banks and two insurance companies in addition to 4,475 savings and loan associations.<sup>1</sup> Most of these associations are mutual thrift organizations that confine their business almost exclusively to the channeling of savings into residential mortgages. In the postwar period, they have been among our fastest growing financial institutions, raising their share of institutional savings from 8 per cent in 1945

to more than 20 per cent in 1957.<sup>2</sup> At the end of 1957, the member institutions of the FHLBS held more than one third of the country's nonfarm one-to-four-family mortgages outstanding.

It has become generally accepted that the FHLBS in fact as well as in name is a kind of central banking system. It consists of a central Board, 11 regional Banks, and the member institutions; in addition, a Government corporation for the insurance of members' savings capital is closely associated with the FHLBS. The Federal Home Loan Bank Board has three members, each of whom is appointed by the President with the advice and consent of the Senate for a four-year term. The Board formulates over-all policies and supervises the member institutions and the 11 Home Loan Banks. The Board also appoints four directors of each Home Loan Bank and conducts the election of the other directors by each Bank's member institutions. In addition, the Board approves the election of the Bank's officers and counsel as well as their dividend declarations and operating budgets; the Board also issues the Banks' consolidated obligations. Another activity under the Board is the Federal Savings and Loan Insurance Corporation (FSLIC), which insures savings capital in all

<sup>1</sup> All Federally chartered associations and about three fifths of those with State charters are members of the FHLBS. For a more detailed survey of savings and loan associations see "Savings and Loan Associations in the Mortgage Market", *Monthly Review*, July 1956, pp. 94-7.

<sup>2</sup> Institutional savings are defined here as the sum of shares in savings and loan associations, of time and savings deposits with commercial and mutual savings banks, and of reserves of life insurance companies.



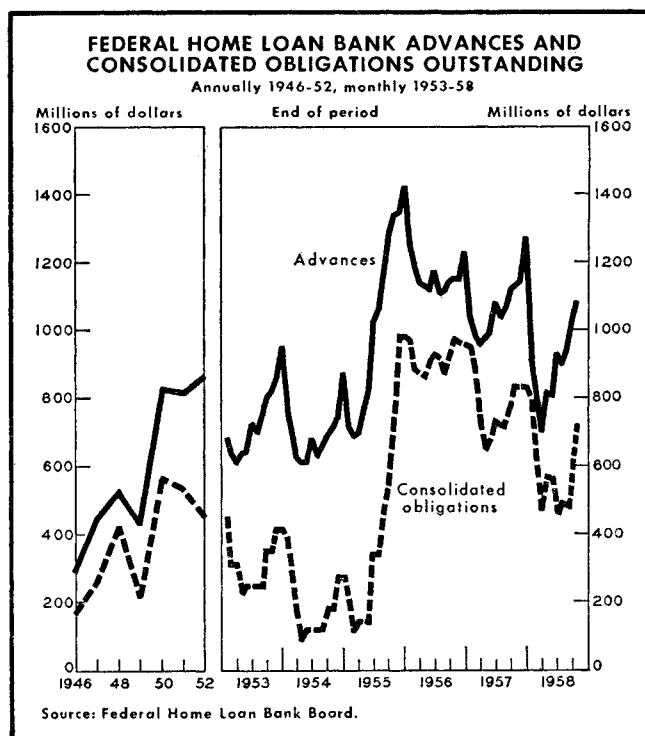
Federally chartered institutions and those State-chartered institutions that apply and qualify. The FSLIC insurance program protects savers in its member associations against financial loss up to a statutory limit of \$10,000. At the end of 1957, insured associations held over 90 per cent of the savings at all operating associations in the country.

#### CREDIT ADVANCES BY FEDERAL HOME LOAN BANKS

Member institutions of the FHLBS may supplement their resources, under certain conditions, by credit accommodation at the 11 Federal Home Loan Banks. Each Bank deals only with member institutions in its District; and the credit advances granted reflect the characteristics of mortgages, which constitute about 80 per cent of the members' assets. Thus credit advances may be long term, although not necessarily so, and are granted to qualified member institutions for a number of reasons, among which are heavy seasonal, or unusual, demands for mortgages (or cash withdrawals) that cannot be satisfied out of the current inflow of savings capital and mortgage repayments.

Long-term advances (defined by statute as having a maturity of more than one year) are secured primarily by home mortgages and are amortized in quarterly instalments. In this fashion, the accommodation of member institutions at the Home Loan Banks is geared to the nature of the collateral pledged: as the associations' private borrowers pay off monthly instalments on their home mortgage loans, member institutions in turn acquire the funds with which to amortize their Home Loan Bank advances. Of the nearly \$1.3 billion of advances outstanding on December 31, 1957, about \$900 million were on a secured basis; these were collateralized by home mortgages having unpaid balances of over \$1.9 billion, United States Treasury securities with a face value of about \$120 million, and other approved security with a face value of \$9 million.

At the end of 1957, 40 per cent of outstanding advances were long term, that is, had a maturity of more than one year. While this over-all ratio describes the maturity distribution of all outstanding advances, it cannot reflect the policies of any one Home Loan Bank, since such policies show considerable variation. In the recent past, four of the 11 Banks were granting members ten-year advances, while on the other hand four Banks were not making any advances at all that were for longer than one year; advances obtained at the remaining three Banks had maximum maturities of three to five years. Whatever the maturity composition of advances may be, the accompanying chart strongly suggests that, while the average level of advances in the postwar years was related to the rate of building activity, the sizable intrayear fluctuations reflect the allevia-



tion of seasonal needs of member institutions. An illustration of this point is provided by the experience of the Home Loan Bank of New York, which has been making more long-term advances than short-term, but which concludes nevertheless that "advances to members in the Second Federal Home Loan Bank District follow a pattern strongly influenced by seasonal considerations".<sup>3</sup>

Practices with respect to short-term advances, and interest rates charged on both short-term and long-term advances, also vary from Bank to Bank. At the end of 1957, for example, the lowest interest rate was 4 per cent (charged by several Home Loan Banks), and the highest rates were in San Francisco, where they ranged from 4½ per cent to 5 per cent depending upon the maturity of the advance.

In addition to the different conditions attached to long- and short-term advances among the 11 Home Loan Bank Districts, there are limitations on the total indebtedness of any member institution. These limitations are based on statute, and on the administrative rules and regulations of the FHLB Board, the FSLIC, and the 11 Banks. By law, advances to a member institution may not exceed twelve times the amount of capital stock it holds in its regional Bank. (Each member institution must hold capital

<sup>3</sup> Federal Home Loan Bank of New York, *25th Annual Report*, pp. 10 and 29.

stock in its regional Bank at least equal to 2 per cent of the unpaid principal of its mortgage loans.) The FHLB Board has further limited a member's borrowing from all sources to half the member's net assets, or half of its share capital, whichever is lower. Within the confines of all of the above, the 11 regional Banks set up their own credit lines for the individual members, again with some variations among their policies.

While advances have of course been important in supplying liquidity to ease occasional tightness in the mortgage market, it is noteworthy that the fivefold growth in the mortgage holdings of members of the FHLBS in the postwar period has been based mainly upon the rise in savings and loan shares.<sup>4</sup> Members' savings capital has risen from \$7.6 billion in 1946 to \$40.4 billion in 1957. The expansion in advances, on the other hand, has been much smaller—from \$300 million to \$1,300 million.

#### **SOURCES OF FUNDS FOR FEDERAL HOME LOAN BANKS**

One of the basic reasons for the creation of the FHLBS was to provide a way by which home-mortgage lending institutions might have access to the capital markets. While the initial Bank funds were provided by the Federal Government, these have since been repaid, and both the FHLBS and FSLIC now operate entirely on private capital. The debt issues of the FHLBS—of which over \$700 million are now outstanding—are the “joint and several” obligations of the 11 Banks and are not guaranteed by the Government.

Through 1957, all consolidated obligations carried short-term maturities that could readily be adjusted to the seasonal and other changes in outstanding advances. The chart already cited shows clearly the nearly parallel fluctuations in outstanding obligations, on the one hand, and advances on the other. The total volume outstanding has remained far below the maximum permitted by statute, which is twelve times the total paid-in capital stock and legal reserves of the Banks. Using this formula, the legal limit at the end of 1957 was about \$8.6 billion, or more than ten times the \$825 million outstanding on December 30, 1957.

Stock subscriptions by member institutions constitute an important source of internal funds, totaling \$700 million at the end of 1957. Reflecting the sharp expansion in postwar mortgage holdings of member associations and

a 1950 increase in required FHLBS stock subscriptions from 1 to 2 per cent of mortgage loans, member stock holdings have risen more than sevenfold since the end of World War II.<sup>5</sup>

Another source of internally generated funds consists of deposits made by member institutions with their District Banks. Many savings and loan associations find it convenient to deposit a share of their liquid funds with the Banks as time deposits since it is an essentially riskless way of achieving interest-bearing liquidity; interest rates on such time deposits in 1957 ranged from 1½ per cent to 3 per cent among the 11 Banks. The Banks may use some of these funds to finance advances to member institutions.

In addition to these internal and external sources of funds, various techniques are used in the FHLBS to shift mortgage money within the country to make more effective use of available funds. A Federal Home Loan Bank in a District with surplus funds may make an “interbank deposit” with another Bank experiencing a relative shortage, thereby smoothing the interregional flow of mortgage credit. During 1957, interbank deposits totaling \$120 million were made, of which \$77 million were repaid and \$43 million remained outstanding at the year end. Interbank deposits have been in use since the mid-thirties, and, more recently, have been supplemented by a similar device on the member-institution level. Since March 1957, the Board has permitted insured associations to acquire up to 50 per cent “participation loans” in conventional mortgages on homes located outside their regular lending areas; such loans must be originated and held by another association insured by the FSLIC. Through the first half of 1958, transactions in participation loans amounted to nearly \$100 million, with the northeast area of the country active in supplying funds, and the southeast and southwest areas on the receiving side.

#### **CREDIT POLICY ADMINISTRATION IN THE FEDERAL HOME LOAN BANK SYSTEM**

The FHLB Board sets a ceiling on the amount of borrowing the FHLBS will undertake in the capital market after consultations with the 11 Home Loan Banks, the Treasury, and the Federal Reserve System. By setting the amount of such borrowing, the Board places an over-all limit upon the credit advances that the 11 Banks can make to their member institutions. In addition, the Board imposes credit restraints when conditions warrant.

Thus, shortly after the inception of the Korean conflict, the Board called upon the 11 regional Banks to curb ad-

<sup>4</sup> Legally, the savings capital for savings and loan associations consists of share interests rather than deposits, and shareholders are considered part owners of the associations rather than creditors. Strictly speaking, a “withdrawal” is a repurchase of shares which the associations are under no legal obligation to make if reasonable notice is not given, or if the withdrawal would impair their financial position.

<sup>5</sup> Dividends paid on this stock vary among the 11 Banks, ranging from 2 to 2.5 per cent in 1957.

vances made to members for the purpose of making new loan commitments or for loan expansion. This restriction preceded the imposition of broader and more general real estate credit controls, such as Regulation X, by several months. Credit restrictions were eased or modified in most of the Banks during 1952.

The Board gained a potential tool of credit control in 1950 when it required member institutions to maintain a liquidity reserve. Under an amendment of the basic statute, approved June 27, 1950, no member of the FHLBS may make or purchase a loan unless its cash and Government securities portfolio satisfy the regulations of the Board; a liquidity requirement of cash and Governments at least equal to 6 per cent of withdrawable accounts was established in December 1950, and has since remained in effect.

The Board again restricted credit in 1955. During the year, demand for mortgage financing from savings and loan associations far exceeded funds supplied by mortgage repayments and deposits, and as a result the volume of credit advances requested by members from the 11 Banks was considerably greater than in previous years. In order to coordinate the operations of the FHLBS with other over-all anti-inflation measures, the Board issued a cautionary letter to the 11 Banks in July 1955 calling attention to the rapid rise in the demand for housing credit and asking for some restrictions on advances. Member institutions, however, turned to the Home Loan Banks for more advances because the rise in the demand for mortgage funds was accompanied by a decline in the rate of savings. In order to slow down this expansion of credit, the Board ordered on September 8 that no further Bank credit would be available to any of its members for additional mortgage commitments.

Nevertheless, the Board's new money borrowings in the capital market, and advances to members by the 11 Banks, roughly doubled during 1955. But by the end of the year, savings and loan associations had just about worked off their 1955 mortgage commitments, the rate of mortgage lending was on the wane, and the Board was able to reduce its restrictions. By September 1956, the Banks could make new advances to members up to 12.5 per cent of withdrawable accounts, in addition to emergency advances equal to 2.5 per cent, for a total of 15 per cent of withdrawable accounts.

Early in 1958, the Board took a further step to ease the conditions under which members could borrow from the

Home Loan Banks. Whereas previous relaxations of credit restraint had primarily provided leeway to meet temporary and seasonal needs of member institutions, the Board floated a \$290 million issue of five-year bonds in April 1958 for the express purpose of providing funds for a more permanent expansion of the lending potential of member institutions. This policy shift was in keeping with other measures of the Federal Government taken early in 1958 to increase the availability of funds to prospective home owners. In October 1958, in a move to ease residential credit for low- and medium-priced houses, the Board permitted Federally chartered savings and loan associations to make loans with reduced downpayment requirements.

Finally, the Home Loan Banks' interest rate policies also affect the level of advances. At the end of 1954, interest rates on advances ranged from  $2\frac{1}{4}$  to  $3\frac{1}{2}$  per cent among the 11 Banks, but as the Banks' own borrowing costs in the capital market were increased, these upward adjustments were passed on to members through higher rates on advances. At the end of 1957, rates on short-term advances had reached 4 to 5 per cent. Thus by 1957 the Banks had raised rates to about one and one-half times the 1954 level.

#### CONCLUSIONS

In summary, the Federal Home Loan Board and Banks perform a number of central banking functions which have increased the strength and resiliency both of member associations and of the mortgage market. Temporary shortages of mortgage funds have been alleviated in part by member borrowings from the Home Loan Banks and, more recently, by shifts of available funds from one part of the country to another. At the same time, central institutions of the FHLBS provide other services that also are important to the functioning of the member institutions. Among these are the periodic examination of members' accounts and the chartering of new members, while the FSLIC insures members' savings capital.

During the 1958 recession the Board took steps to facilitate the flow of mortgage credit to the home buyer by floating longer term bonds in the capital market with a view to permitting a larger volume of advances to members. On the other hand, in the 1950 and 1955 periods of inflationary pressures the Board slowed the expansion of mortgage credit by limiting borrowing by member institutions.