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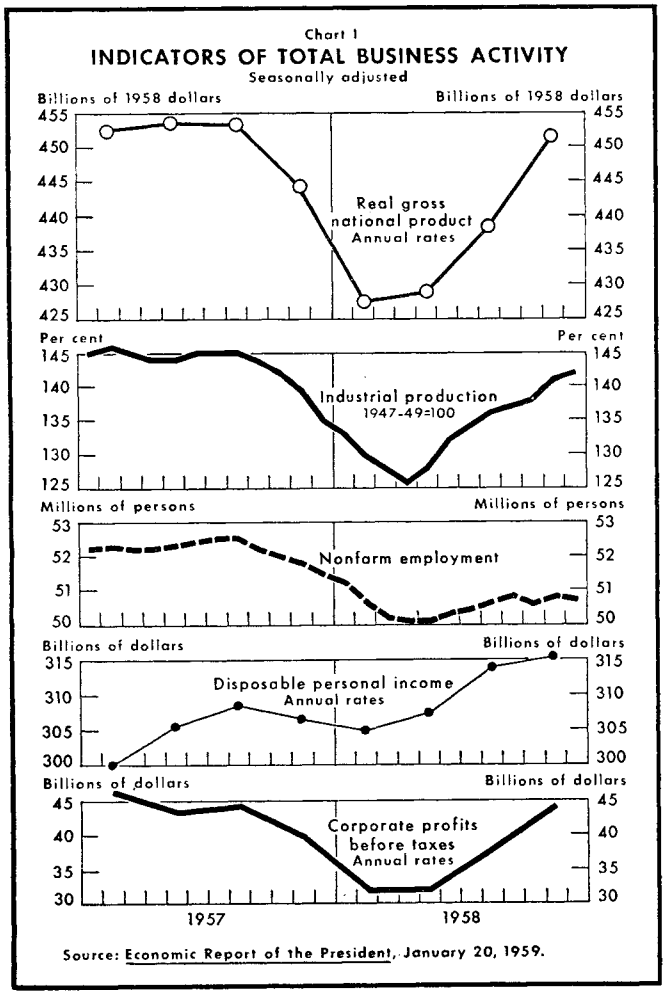
The Business Situation

Although the usual post-Christmas "breathing spell" has slowed business activity in some parts of the economy, the vigorous upswing that characterized the last part of 1958 has continued in early 1959. Record holiday sales left many merchants and some manufacturers with shelves bare, and reordering is said to be brisk. Rebuilding of automotive and steel inventories may have accelerated, and inventory accumulation appears to be beginning in several other lines. In addition, construction activity advanced further (except as hampered by poor weather), reflecting the increases in housing starts and road-building contracts in late 1958. Moreover, the recent flow of industrial and other business construction awards, and a rise in machine tool orders, tend to indicate that the long decline in business outlays on plant and equipment may now be over, as was earlier suggested by surveys of business spending plans.



Most of the comprehensive measures of output and income closed the past year with rises to record or near-record levels. The total physical output of goods and services (real GNP) rose 3 per cent from the third to the fourth quarters, and reached a level nearly matching the previous peak in mid-1957 (see Chart I). Manufacturing and mining output, as measured by the Federal Reserve index of industrial production, increased 1 point further in December, the eighth consecutive monthly rise. The total index was still 3 per cent below its all-time high, largely reflecting the incomplete recovery in the capital goods industries and in mining, but output of nondurable goods was well ahead of its pre-recession peak. Privately financed housing starts jumped in December to a seasonally adjusted annual rate of over 1.4 million units, more than 50 per cent above the February low and very close to a new record. Retail sales, which had been relatively sluggish for several months, also spurted in December, with auto, department store, and apparel store sales increasing sharply. According to preliminary data, total retail dollar volume (seasonally adjusted) set a new record by a substantial margin.

While personal income dipped slightly in December from the record November rate, this was due to a largely statistical drop in the seasonally adjusted rate of dividend receipts, as year-end "extras" for the third straight year were substantially less than was usual in most earlier years. Receipts from government benefits also declined. Labor income continued to expand, however, mainly as the result of rising pay-scales and more overtime. Meanwhile, corporate profits advanced by 16 per cent in the fourth quarter, according to early estimates, to reach a seasonally adjusted annual rate approaching that of the record years 1955 and 1956.

As has been the case since late summer, gains in employment failed to match the pace of expansion in output and demand. Nonfarm employment rose less than seasonally in December; trade and post office employment increased by the usual large amount, but construction employment dropped more than normally because of unusually bad weather. In seasonally adjusted terms, the total number of nonfarm wage and salary workers was still

1¾ million below the July 1957 high. Moreover, the number of private nonfarm jobs was actually more than 2 million short of the pre-recession peak, government employment having expanded by 400,000 in the interim.

The poor weather in December was also a factor in the slight rise in unemployment, to 6.1 per cent of the labor force (seasonally adjusted) from 5.9 per cent in November. In 1958, as in 1957, the growth of the labor force (people at work or looking for work) was smaller than long-run population trends would imply. On the average, the total labor force in 1958 was about half a million persons larger than in 1957, compared with an average annual rise of one million during the preceding decade. The number of people not now looking for work who might re-enter the job market as employment opportunities improve may therefore be relatively large.

Despite the slow improvement of the labor market, the exceptional buoyancy of consumer buying during the holiday season testifies to the strengthening of public confidence in the economic outlook. Consumption outlays increased in the fourth quarter by substantially more than the gain in disposable personal income (personal income less income taxes). A large part of the increased spending, moreover, went for autos, household durables, and other nonroutine ("discretionary") purchases. Such purchases were particularly strong in December. Since 1955, however, sales have shown an unusually pronounced tendency to sharp, but short, spurts around holiday and vacation periods. This apparently occurred again in late 1958; in January 1959, according to partial data, auto and department store sales fell back from the high rates achieved during the December sales burst.

The reduction in the rate of personal saving, as outlays rose far more than income, naturally cannot be repeated indefinitely. At some point, any further substantial increase in consumer buying will be dependent on gains in real family income. It is significant that real per capita income after taxes is still about 2 per cent below the peak reached in mid-1956. Moreover, the portion of such income set aside for credit repayment and other fixed commitments has increased. Of course, even if per capita incomes did not expand but instead remained stable, the total volume of sales would expand along with the growing population. While there is no doubt that many businesses would prosper under these circumstances, there is general agreement that the economy is capable of providing not merely a stable, but a rising standard of living.

Given the rather ample capacity now existing in many industries, there is room for an appreciable increase in per capita income and consumption over the coming months. But to achieve this without touching off another round of inflation, the gains in real income should be brought about through lower prices for at least some products, which would stimulate increases in the over-all volume of sales and hence in output, employment, and profits—a sequence which did much to launch the vigorous upswings that began in 1949 and 1954.

THE OUTLOOK FOR PRICES

During the second half of 1958, the consumer price index held virtually unchanged (see Chart II). Developments during this period may be summarized as follows. Food prices were declining about seasonally, after having advanced sharply more than seasonally earlier in the year. Prices of manufactured goods were rising, probably somewhat more than seasonally, after having declined about seasonally earlier in the year. Service prices, meanwhile, continued to advance, but at a distinctly slower pace than in the preceding two years.

Looking ahead, food prices—which represent some 30 per cent of the cost of living (see Chart III)—seem to offer the best prospects for some decline. Some drop could occur merely if the weather in farm areas turns out to be better this year than in 1958. The harsh winter last year sharply reduced fruit and vegetable crops and resulted in a steep run-up in prices of fresh produce as well as substantial price rises for some frozen and canned goods.

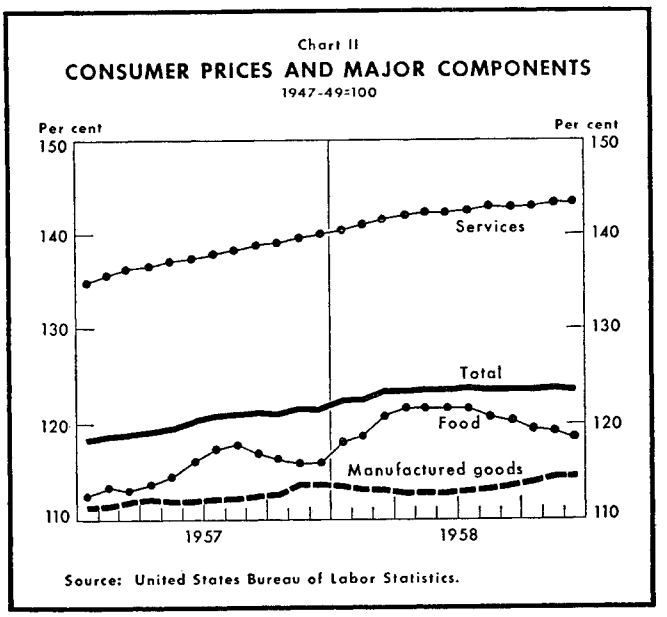
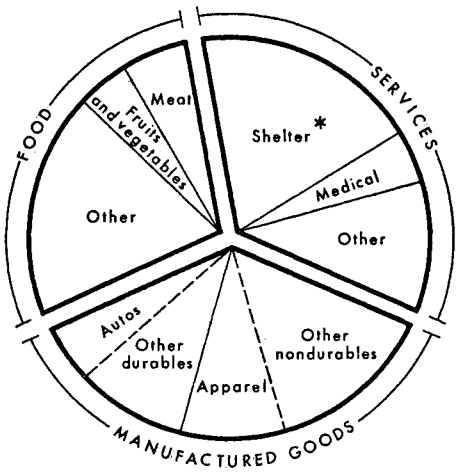


Chart III

RELATIVE IMPORTANCE OF MAJOR ITEMS IN THE CONSUMER PRICE INDEX, DECEMBER 1957



* Includes rent, home purchases, mortgage interest, real estate taxes and insurance, repair services, utilities, and telephone service.

Source: United States Bureau of Labor Statistics.

Hopefully, this pattern may not be repeated this year, although the reduced stocks of many frozen and canned goods may continue to exert some upward pressure. The other major source of higher food prices in 1958 was the sharp advance in meat prices; meat rose much more than seasonally in the first half of the year, and declined only about seasonally in the second half. Farmers have been sending fewer animals to market, partly because they have been building up their cattle herds. A period of increased marketings and lower prices is almost bound to follow eventually, however. Pork prices are expected to decline this year, while beef prices are likely to decline by 1960, and possibly sooner.

In contrast to the outlook for food prices, the rise in the cost of services and shelter (about a third of family budgets) seems likely to persist. This rise, which has continued almost uninterruptedly since before World War II, has slowed down substantially since early 1958, however —from a rate of about 4 per cent annually in the previous two years to about 2 per cent currently. While fully detailed data are not available beyond September, the slowing-down apparently reflects partly a leveling-off in the cost of scattered items such as movie admissions, beauty shop charges, and some repair and maintenance services, as well as a decline of mortgage interest rates. Prices of other services, such as utilities, transit fares, and medical services, continued to advance rapidly, although in some cases not so fast as before. Recent developments in the mortgage market suggest the possibility of some renewed increase in mortgage rates.[1]

The remaining part of consumer budgets—more than a third—consists of manufactured goods. With food prices possibly declining and service prices rising, the behavior of prices of manufactured goods may in effect determine the trend of consumer prices over the coming months. Price developments in this sector in 1957-58 contrast markedly with the changes that occurred in the previous postwar recessions. In 1948-49, retail prices of both durable and nondurable manufactured goods declined. In 1953-54, nondurable goods were more or less steady in price, but durable goods declined—reflecting the spread of the discount practice. In 1957-58, however, apart from seasonal fluctuations, both durable and nondurable goods prices were steady—except for automobiles, a major component of this group, for which prices increased.

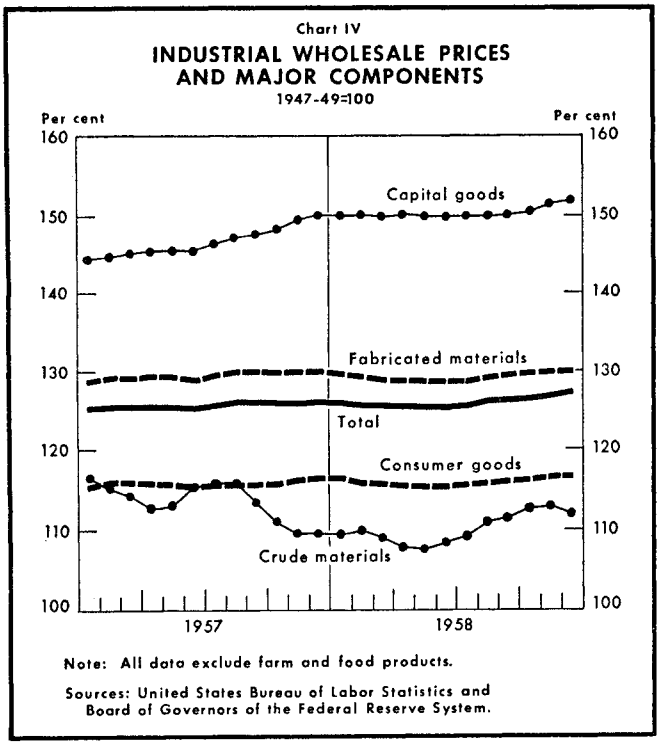
As expansion continues, upward pressures on consumer goods prices may intensify. Since midyear, wholesale prices have increased for a number of key industrial products and the price rise, while slow, appears to be broadening somewhat. In addition, the most recent labor agreements have included wage increases that seem on the generous side, compared with the average gain in productivity in the economy as a whole (although to a lesser extent than in 1955-57), and profit margins also have been rising. Finally, the increases in various sales and excise taxes now proposed at all levels of government, if enacted, are likely to be passed along at the retail level.

On the other hand, there are also strong counterforces. Recent surveys of consumer attitudes and spending plans concur in reporting a ground swell of resentment at higher prices. The feeling that prices are high, some analysts believe, leads to the deferral of buying plans for durable goods—people may consider it cheaper to get maximum use out of what they already have than to pay prices they regard as exorbitant for new replacements. The price reductions put into effect by the large mail order firms, various press reports that some retailers plan to hold the price line, and the relatively strong showing of economy cars all suggest that the consumer is expressing his resistance to higher prices in the market place.

[1] In principle, the consumer price index should not be affected by price changes which reflect simply changes in the quality of the product. Accordingly, the Bureau of Labor Statistics draws up detailed specifications in an effort to ensure that the products priced from month to month are of comparable quality. However, a completely satisfactory adjustment for quality may not always be feasible, especially for some service items.

Interpretation of recent developments in prices at the wholesale level is more difficult than of retail price changes, due to differences in the methods used to compile the official indexes. The consumer price index attempts to measure the prices people are actually paying. Reporters are sent to the stores to note the prices marked on merchandise or to obtain quotations from salesmen or managers. The wholesale price index, on the other hand, relies to a very great extent on list prices and consequently may not fully reflect unpublicized discounts and other forms of price shading. Unquestionably, discounts on industrial goods were relatively common in early 1958, but have subsequently narrowed considerably or disappeared. However, the size of the discounts and the proportion of transactions involved are not easy to ascertain.

According to the official wholesale price indexes, raw materials prices in 1958 as always were highly responsive to changing business conditions; on the other hand, prices of fabricated materials and finished goods, and particularly of metal products, were relatively inflexible (see Chart IV). Prices of crude industrial materials and fuels dropped sharply during the business contraction, reflecting enlarged capacity, inventory liquidation, and reduced consumption. Following the business upturn in May, these prices advanced rapidly for a time, not only because of improved demand, but also because of measures to restrict certain basic commodity imports and because of a strike that curtailed African copper production. More recently, however, the rise has come to a halt, with average prices still at a level below that of mid-1957 and considerably below the high reached during the Suez crisis in late 1956. Prices of fabricated materials and especially of durable materials, on the other hand, responded only slightly to the recession (discounts aside) and have been advancing since the steel price increase in midsummer. Even though prices of many nondurable materials such as textiles, chemicals, and petroleum are still below earlier peaks, the average for all fabricated materials is back to the pre-recession high. Wholesale list prices of finished consumer and capital goods, like prices of semimanufactures, also remained virtually unchanged during the recession, but have tended to rise in the last few months, principally reflecting higher prices on automobiles and several types of machinery.



PRICES AND FOREIGN TRADE

The contrast between the sharp drop in our exports during the recession and the steadiness of imports has led to some apprehension that United States producers may be pricing themselves out of the world market. Of course, factors other than prices have played the principal part in reducing our exports. These include the reopening of the Suez Canal and the fall in our petroleum exports, the decline in subsidized exports of surplus farm commodities, the decline in foreign demand associated with business recessions abroad, and the payments difficulties experienced by many underdeveloped countries as a result of price declines for their principal raw materials exports. However, foreign competition has certainly grown more intense, both at home and abroad. Furthermore, sales in international markets appear to be turning more and more on price. The advantage of large capacity and advanced techniques, held by the United States because of the war destruction in other industrial countries, has been largely whittled away, and foreign producers now are frequently able to offer the same quick delivery and high quality as United States firms. The increasing attractiveness of lower costs abroad also may tip the scales in cases where American firms may be considering shifting overseas some of their manufacturing operations for foreign markets.

On the other hand, the fact that many countries still apply discriminatory restrictions to imports from the dollar area suggests that there are many products in which the

United States retains a considerable competitive advantage. The recent extension by most West European countries of convertibility privileges to nonresidents was accompanied by the further relaxation of discriminatory import restrictions on American goods only in France, which had lagged behind other West European countries in this respect. The relaxation of such restrictions more or less generally, however, would appear to be a logical consequence of a successful transition to the new currency system. But even if our exports were to increase substantially, it must be recognized that the gradual freeing of restrictions on international trade will tend to promote greater regional specialization, in the same way as does the large market area within our own borders. While this is a process that confers important economic benefits—on an international just as on a domestic scale—it is also one that may have very uneven impacts on different industries and areas, favoring some and requiring painful adjustments in others. But this is probably an inevitable consequence of industrial growth, and will have to be accepted if the United States is to share in the improvement of standards of living that the free world expects to achieve through freer trade and payments.

CONCLUSION

With the advent of the new year, the economy's total output has once more begun to set new records, and the vigorous expansion in demand has of course also increased upward pressures on some prices. A major question mark in the outlook for 1959 is whether these pressures will become so strong as to disrupt the current stability in the cost of living. The outcome may well hinge on the many critical policy decisions, public and private, that must be taken during the coming months. The more general adoption by business and labor of policies aggressively aimed at "high volume at lower prices" would go far toward helping the nation to realize its full potential for economic growth.

Money Market In January

The money market retained a firm tone during January. System open market operations absorbed the seasonal release of reserves by market factors and maintained a moderate degree of pressure on bank reserve positions. The effective rate for Federal funds generally held at the 2½ per cent ceiling, although there were occasional reports of trading at slightly lower levels.

Government securities prices declined further over the month, extending the downward movement that had begun in December. Market sentiment was bearish over much of the period, reflecting both the uncertainties connected with the Treasury's $15 billion February refunding operation and the expectation that the continued improvement in business activity would lead to further tightening of credit. In mid-January the Treasury sold $3¼ billion of securities for cash, a somewhat larger amount than had been anticipated. Despite their initially attractive yield, the unfavorable market climate soon caused the two new securities to fall slightly below their original offering price. Toward the end of the month the market tone improved somewhat in response to rumors suggesting that the February exchange offering, originally expected to include a longer bond, would be confined to shorter maturities. Moreover, market opinion turned to the view that any credit-tightening measures in prospect for the near future had already been discounted. Yields on corporate and municipal bonds moved higher over the month in response to the influences affecting the Treasury market and to the substantial calendar of new municipal financing for the months ahead.

On January 29 the Treasury announced the terms of its February refunding operation. Holders of $14.9 billion of the maturing securities were offered a choice of a 3¾ per cent one-year certificate of indebtedness to be dated February 15 and due February 15, 1960 or a 4 per cent three-year Treasury note to be dated February 15 and maturing February 15, 1962. The maturing securities include $9.8 billion of 2½ per cent certificates of indebtedness due on February 14 and $5.1 billion 1⅞ per cent notes due on February 15. Holders of the certificates electing to exchange into the new securities will be allowed a discount on the price of the new issues equivalent to one day's interest. Subscription books for the exchange will be open on three days, February 2 through February 4. The exchange offering met with a favorable initial response in the market.

MEMBER BANK RESERVE POSITIONS

Reserve positions of member banks were under steady, though moderate, pressure throughout the month of January, as a sizable net reduction in System holdings of Government securities was employed to absorb large reserve gains accruing from the seasonal currency return and other influences. From time to time, repurchase agreements were extended to moderate localized pressures, particularly around the time of payment for the new issues of Treasury notes and bonds. Net borrowed reserves for the four statement weeks ended in January averaged $64 million, slightly higher than the $41 million average for December. Average excess reserves, at $503 million, were $13 million lower than in December, while average borrowings rose by $10 million to $567 million.

System securities sales or redemptions were made in fairly substantial volume during the first three statement weeks of January, when currency was rapidly pouring back into the banking system and seasonal repayments of bank loans were releasing required reserves. The reduction in System securities holdings in the third statement week offset only part of the unexpectedly large midmonth expansion of float, and free reserves emerged, on one day exceeding $250 million. Nevertheless, reserve pressures failed to lift from banks in the money centers, and the money market remained tight.

The System sold only a moderate amount of securities in the final statement week of the month, when the return flow of currency slowed, float receded, and required reserves increased. The rise in required reserves late in the month reflected the expansion of deposits on January 21 and 23, when banks made payment for their purchases of the new Treasury securities by crediting Treasury Tax and Loan Accounts.

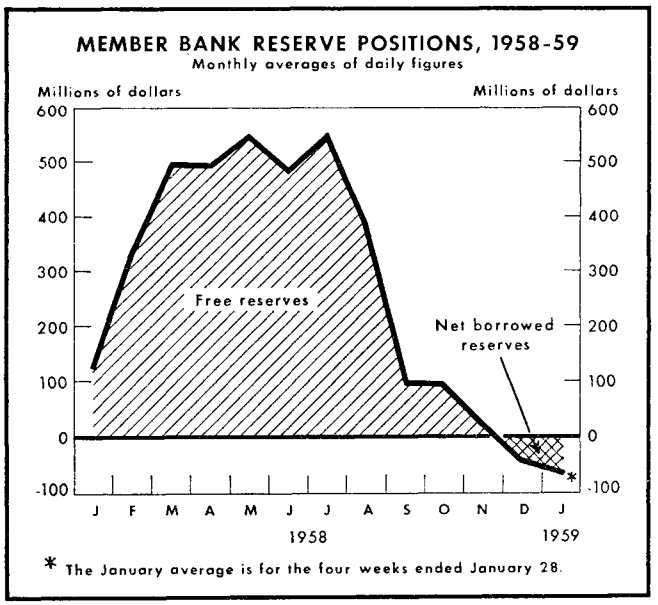


Table I
Changes in Factors Tending to Increase or Decrease Member Bank Reserves, January 1959
(In millions of dollars; (+) denotes increase, (—) decrease in excess reserves)

Factor	Daily averages—week ended				Net changes
	Jan. 7	Jan. 14	Jan. 21	Jan. 28	
Operating transactions					
Treasury operations*	+ 70	+ 53	— 19	— 4	+ 100
Federal Reserve float	— 217	— 390	+ 277	— 214	— 544
Currency in circulation	+ 448	+ 298	+ 325	+ 235	+1,306
Gold and foreign account	+ 61	— 26	— 71	+ 59	+ 23
Other deposits, etc.	+ 20	+ 12	— 25	+ 30	+ 37
Total	+ 382	— 53	+ 485	+ 108	+ 922
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	— 151	— 273	— 237	— 109	— 770
Held under repurchase agreements	— 102	+ 11	— 105	—	— 196
Loans, discounts, and advances:					
Member bank borrowings	— 164	+ 87	— 275	+ 51	— 301
Other	—	—	+ 1	—	+ 1
Bankers' acceptances:					
Bought outright	+ 1	+ 1	— 1	— 2	— 1
Under repurchase agreements	— 1	— 2	— 1	—	— 4
Total	— 418	— 177	— 617	— 60	—1,272
Total reserves	— 36	— 230	— 132	+ 48	— 350
Effect of change in required reserves†	— 61	+ 219	+ 70	— 181	+ 47
Excess reserves†	— 97	— 11	— 62	— 133	— 303
Daily average level of member bank:					
Borrowings from Reserve Banks	626	713	438	489	567‡
Excess reserves†	575	564	502	369	503‡

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 January 28.

Over the four statement weeks ended January 28, currency in circulation fell by $1.3 billion, or by approximately the amount of the increase since last July. The effect of this flow was partially cushioned by a $544 million seasonal drop in float. System holdings of short-term Treasury obligations declined by $910 million between December 31 and January 28, including $815 million sold or redeemed from the System Account and $95 million under repurchase agreements.

GOVERNMENT SECURITIES MARKET

Activity in the market for Treasury notes and bonds during January was largely confined to tax-switching transactions, the volume of which expanded markedly after the turn of the year. During much of the month, attention was centered on the Treasury's $3¼ billion cash-financing operation, the terms of which were announced after the

close of the market on January 8. Later in the month, speculation about the terms of the Treasury's February refunding dominated market developments.

The January cash offering included $2.5 billion of 3¼ per cent sixteen-month notes, dated January 21 and to mature May 15, 1960, issued at a price of 99.75 per cent of face value (equivalent to a yield of 3.45 per cent) and $750 million of 4 per cent 21-year bonds, dated January 23 and due February 15, 1980, issued at a price of 99.0 per cent of par (equivalent to a 4.07 per cent yield). The flotation was the second recent instance in which Treasury securities were issued at a discount from face value; similar pricing had been used in last November's refunding. While the size of the offering was larger than had earlier been indicated, the Treasury at the same time made it known that for the time being it was suspending its program, which had been expected to continue through March, of raising $200 million of new money through Treasury bill auctions each week.

In order to discourage speculative subscriptions to the new securities, the Treasury required a cash downpayment of 15 per cent with all nonbank subscriptions for the bonds. Also, the Treasury reserved the right to make preferential allotments of the bonds to savings-type investors and, in order to encourage subscriptions from these investors, offered them the option of making payment in four monthly instalments through April 23. The savings-type investors specified by the Treasury include insurance companies, pension and retirement funds, savings depositories other than commercial banks, and several others as well. Subscription books for the notes were open on January 12 only, and on January 12 and 13 for the bonds.

The 47 per cent allotment on the notes, announced on January 14, was about in line with market expectations, while allotments of the bonds, announced on January 16, were larger than had been expected. The bonds were awarded on a 70 per cent basis to savings-type investors, on a 35 per cent basis to commercial banks, and on a 15 per cent basis to all other subscribers.

The new 3¼ per cent notes began trading on a "when-issued" basis at $99\frac{23}{32}$, $\frac{1}{32}$ of a point below the issue price, and subsequently the quotation declined moderately to $99\frac{14}{32}$, equivalent to a yield of 3.67 per cent, where it stabilized. In contrast, the quotation on the bonds fluctuated irregularly. After trading briefly at the issue price or higher, the price of the bonds dropped to $98\frac{13}{32}$ and then rose to close the month at $98\frac{24}{32}$, equivalent to a yield of 4.09 per cent. Both new issues were generally under selling pressure; offerings of notes, originating mainly from banks, were partly absorbed on tax swaps, while the rising yield on the bonds generated some outright investment demand for these securities.

Prices of outstanding notes and bonds drifted downward in the first part of January, extending the sharp declines which had taken place in December. The downward movement accelerated around mid-January in a general adjustment to the yields being established on the new Treasury securities, but prices steadied and recovered somewhat toward the close of the month. For the month as a whole, bonds maturing in more than ten years generally lost about 1 point, while shorter issues were off about ½ a point. The average yield on long-term Treasury securities rose to 3.92 per cent at the end of the month from 3.83 per cent at the end of December.

The Treasury bill market tended to be somewhat heavy during early January, reflecting the shrinkage of nonbank demand from its unusually high December level and the absorption by the market of a seasonal decline in System holdings of bills. Later, however, investment demand picked up and dealers were able to reduce their relatively high inventories of these issues. Generally, little enthusiasm was evidenced in the weekly auctions of new bills, and yields rose steadily. In the last January auction, however, bidding for the 91-day bills was rather aggressive, evidencing anticipation of increased demand for these issues around the time of the Treasury refunding. The 91-day bills were awarded at an average issuing rate of 2.678 per cent on January 5, 2.808 per cent on January 12, 3.035 per cent on January 19, and 2.975 per cent on January 26 (compared with 2.690 per cent in the last December auction). Average issuing rates of 2.959 per cent, 3.034 per cent, 3.233 per cent, and 3.337 per cent were established in the respective auctions of 182-day bills (against a rate of 2.920 per cent on December 30). The Treasury continued to offer $400 million of 182-day bills in each bill auction held during January. Beginning on the January 19 auction date, however, the offering of regular 91-day bills was cut to $1.4 billion from $1.6 billion.

OTHER SECURITIES MARKETS

The volume of new financing in the corporate and municipal bond markets expanded seasonally after the turn of the year. New corporate bond flotations for new capital purposes totaled an estimated $375 million in January, compared with $430 million in January 1958 and $260 million in December 1958. Municipal bond issues marketed during the month totaled an estimated $525 million, against $670 million a year earlier and $360 million

in December. Most larger flotations were quickly sold out, but dealers made little progress in distributing unsold balances of earlier offerings. Not infrequently, the corporate issues which sold well carried a stipulation that the debt would not be refunded at a lower interest rate for five years. Many new corporate issues attained premium bids in the secondary market.

Prices of seasoned corporate and municipal bonds declined moderately over the month in light trading. The average yield on seasoned Aaa-rated corporate bonds rose by 6 basis points to 4.16 per cent, and that on similarly rated municipals advanced by 8 basis points to 3.20 per cent. Corporate bond prices tended to fluctuate irregularly in sympathy with the Treasury market, while prices of municipals held relatively steady after an initial decline early in January.

Several changes took place in rates on other short-term debt instruments. On January 20 one major finance company raised its rates by varying amounts for different maturities and, at the same time, split its 30- to 89-day paper into two maturities: 30- to 59-days, on which the old 2¾ per cent rate is still in effect, and 60- to 89-days, on which a new 3 per cent rate will be applied. Rates were lifted by ¼ of 1 per cent to 3¼ per cent for 90- to 179-day paper and by ⅛ of 1 per cent to 3⅜ per cent on 180- to 270-day paper. Rates of the other major finance companies were unchanged at the old levels. On January 21 commercial paper dealers raised their rates by ⅛ of 1 per cent, offsetting a decrease of similar size in December. The dealer rate on prime four- to six-month paper is now 3⅜ per cent.

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

Item	Statement week ended				Four weeks ended Jan. 21, 1959
	Dec. 31	Jan. 7	Jan. 14	Jan. 21	
Assets					
Loans and investments:					
Loans:					
Commercial and industrial loans	+ 269	− 578	− 169	− 231	− 709
Agricultural loans	− 1	− 15	− 5	− 6	− 27
Securities loans	+ 217	− 129	− 307	+ 160	− 59
Real estate loans	+ 5	+ 9	+ 25	+ 21	+ 60
All other loans (largely consumer)	+ 154	− 67	− 27	+ 20	+ 80
Total loans adjusted*	+ 603	− 783	− 483	− 33	− 696
Investments:					
U. S. Government securities:					
Treasury bills	+ 44	− 145	− 39	+ 21	− 119
Other	− 36	− 225	− 219	+1,003	+ 523
Total	+ 8	− 370	− 258	+1,024	+ 404
Other securities	+ 58	+ 28	− 14	− 88	− 16
Total investments	+ 66	− 342	− 272	+ 936	+ 388
Total loans and investments adjusted*	+ 669	−1,125	− 755	+ 903	− 308
Loans to banks	− 541	+ 856	− 84	− 9	+ 222
Loans adjusted* and "other" securities	+ 661	− 755	− 497	− 121	− 712
Liabilities					
Demand deposits adjusted	+ 544	− 296	− 56	+ 499	+ 691
Time deposits except Government	+ 180	− 139	+ 33	+ 35	+ 109
U. S. Government deposits	+ 130	−1,479	− 515	+1,564	− 300
Interbank demand deposits:					
Domestic	+1,390	− 698	− 42	− 993	− 343
Foreign	+ 22	− 65	− 66	− 11	− 120

* 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.

MEMBER BANK CREDIT

Total loans and investments at weekly reporting member banks dropped by $308 million over the four weeks ended January 21, reflecting a substantial decline in loans and a relatively moderate net increase in securities holdings. Loans adjusted declined by $696 million in the period, while portfolios of investments were increased by $388 million.

The $709 million decline in business loans was about half of the $1,434 million business loan contraction in the corresponding period last year and somewhat smaller than that of the same weeks two years ago. Most of the broad industrial borrowing groups repaid loans, on balance, but in most instances the reductions were less than in the comparable weeks ended in 1958 and 1957. Metals and metals products firms, moreover, increased their borrowings contraseasonally by $71 million in the current period. The largest declines occurred in loans to food, liquor, and tobacco processors, which dropped by $198 million, and in loans to trade firms, which were off $177 million; both of these reductions were less than might be expected on seasonal grounds. Similarly, sales finance companies, which had repaid over $350 million of their bank indebtedness last year, reduced borrowings by only $29 million in the latest four weeks.

The reporting banks' holdings of Government securities increased by $404 million, reflecting a $119 million decline in Treasury bills and a $523 million net increase in other types of issues. In the January 21 statement week, when the banks took delivery of the new 3¼ per cent Treasury notes, portfolios of securities other than bills rose by $1 billion, but this increase was partly offset by a preceding sharp liquidation of certificates, notes, and bonds. The banks reduced their holdings of non-Government securities slightly over the period.

Demand deposits adjusted rose by almost $700 million at the weekly reporting banks in the four-week period ended January 21, a much larger increase than in comparable weeks in other recent years. However, the expansion in time deposits of about $100 million fell far short of the rise of $452 million recorded in the comparable weeks of last year and was also less than half the expansion of $276 million recorded in 1957.

International Monetary Developments

MONETARY TRENDS AND POLICIES

Foreign monetary and credit developments in January generally followed the pattern established in 1958. In the industrial and financially developed countries, the trend toward credit relaxation and easier money that got under way about a year ago continued last month. The central banks of Belgium, West Germany, the Netherlands, and the Union of South Africa reduced their discount rates, bringing to over thirty the number of foreign discount rate reductions since the beginning of 1958 (see table); in addition, in Finland the central bank lowered the rate it charges to private nonbank customers. On the other hand, in the primary-producing countries, where inflationary pressures generally persist, the tendency to maintain or strengthen credit restrictions continued. In January, the Central Bank of Argentina raised commercial bank reserve requirements, and the State Bank of Pakistan increased its discount rate.

The extent to which the industrial countries have moved in the direction of monetary ease is indicated not only by the frequency of discount rate decreases in the past thirteen months, but also by the relatively low levels reached by last month's reductions. Thus, the German Federal Bank's new 2¾ per cent rate is the lowest in the history of German central banking; the Dutch rate of 2¾ per cent and the Belgian rate of 3¼ per cent are the lowest since 1956; and the decrease to 4 per cent in the South African rate marks the first change in over three years and reduces it to the level in effect in 1952-55.

Changes in Foreign Central Bank Discount Rates in 1958-59
(In per cent)

Date of change	Country	New rate	Amount of change
1958: January 17	Germany	3½	−½
January 24	Netherlands	4½	−½
March 20	United Kingdom	6	−1
March 25	Netherlands	4	−½
March 27	Belgium	4¼	−¼
March 28	Ireland	5½	−½
April 9	Brazil	8	+2
April 19	Denmark	5	−½
May 3	Sweden	4½	−½
May 22	United Kingdom	5½	−½
May 31	Ireland	5	−½
June 5	Belgium	4	−¼
June 7	Italy	3½	−½
June 14	Netherlands	3½	−½
June 18	Japan	7.665*	−0.73
June 19	United Kingdom	5	−½
June 27	Germany	3	−½
July 3	Belgium	3¾	−¼
August 14	United Kingdom	4½	−½
August 15	Denmark	4½	−½
August 28	Belgium	3½	−¼
September 2	Ireland	4½	−½
September 5	Japan	7.3*	−0.365
October 1	Finland	7¼ †	−¾
October 16	France	4½	−½
November 15	Netherlands	3	−½
November 20	United Kingdom	4	−½
November 28	Ireland	4¼	−¼
1959: January 5	Union of South Africa	4	−½
January 8	Belgium	3¼	−¼
January 10	Germany	2¾	−¼
January 15	Pakistan	4	+1
January 21	Netherlands	2¾	−¼

* "Basic" rate for commercial bills.
† Rate applicable to rediscounting for commercial banks.

While there are, of course, broad differences between the financial and economic climates of the various countries, certain common elements characterized last month's cuts in discount rates. In each case, the reduction primarily reflected a continued increase in gold and foreign exchange reserves and an accompanying rise in market liquidity. In the three Western European countries, the lowering of discount rates at this particular time also attests to the basic strength of their currencies in the foreign exchange markets, following the advent of nonresident convertibility and the implementation of the European Monetary Agreement at the end of December. The German Minister of Economic Affairs, in fact, welcomed the German move as helping to overcome any difficulties that might be encountered by Germany's European trading partners as a result of the convertibility measures. In both West Germany and the Union of South Africa, moreover, the rates were lowered with the express intention of influencing the yield differentials between the financial centers in these and other countries—the purpose in Germany being to stimulate the outflow of private capital, and in South Africa to avoid an inflow of short-term funds that might lead to embarrassing withdrawals in the future.

Concern over domestic economic conditions seems to have been generally absent in Germany and the Netherlands, but may have played a role in the decisions of the Belgian and South African central banks. In Belgium, industrial production remains below the level of last winter and unemployment continues relatively high, reflecting partly some weakening of Belgium's export position. In South Africa, appreciable slackness has appeared in several primary and secondary industries, and the pace of over-all economic activity has slowed down in the wake of the restrictive measures taken in the first half of 1958 to correct the country's external deficit. A beginning was

made in reversing the restrictive policy last November, when the central bank reduced to 6 per cent from 8 the commercial banks' supplementary cash-reserve requirements, instead of raising them to 10 per cent as originally scheduled.

The measures adopted last month in Argentina and Pakistan represent efforts to deal with the severe economic stress that both countries have been suffering for the past few years. Argentina has embarked on a comprehensive stabilization program with the aid of credits from the United States Treasury, the Export-Import Bank, the Development Loan Fund, United States commercial banks, and the International Monetary Fund. As part of this program, minimum reserve requirements for most commercial banks were raised to 30 per cent from 20 as of January 1. The banks also were requested to pursue a more selective lending policy and to restrict nonessential loans. The discount rate increase in Pakistan marks the first change in the rate since the central bank was established in 1948. At the same time, control over all foreign exchange earnings was lodged with the central bank, and an export bonus plan, designed to increase foreign exchange earnings, was introduced. These moves follow indications that the authorities will speed up various agricultural development projects that had been subordinated to industrial expansion.

In addition to the foregoing measures, steps further liberalizing external payments were taken in January by two countries—West Germany and France. These steps followed in the wake of the convertibility for nonresidents announced by twelve European countries at the close of 1958.[1] The German authorities on January 13 extended virtually full convertibility privileges to German residents as well, thus giving formal recognition to *de facto* arrangements that had already been in effect for some time. Certain nominal restrictions remain, however, on some types of capital transactions as well as on some transactions in goods and services.

The French authorities on January 21 abolished the "capital franc" and thereby granted convertibility to the proceeds from the sale of most foreign investments in France—specifically those made by residents of the dollar area, of most European countries, and some countries of Latin America. Convertibility and repatriation privileges had already existed for authorized foreign investments in dollars and certain other currencies that had been made in France since September 1949. The proceeds from all other foreign investments, however, had to be credited to the now abolished "capital franc" accounts, and could only be reinvested in France or sold at a substantial discount. The abolition of the "capital franc" followed upon a considerable improvement in France's international reserve position, which in the first three weeks of January swelled French gold and foreign exchange holdings by some $300 million equivalent, or some 30 per cent.

[1] For a fuller discussion of the convertibility measures, see "International Monetary Developments", *Monthly Review*, January 1959.

EXCHANGE RATES

As expected, the nonresident convertibility of most Western European currencies announced at the end of December has resulted in an increase in exchange activity not only in sterling but also in the Deutsche mark, the Scandinavian currencies, and the Swiss, French, and Belgian francs. There was considerable trading in sterling for spot delivery in New York, representing operations by commercial interests (oil, diamonds, rubber, and grain) and arbitrage transactions. Lower quotations prevailed during early January, occasioned by demand for United States dollars in London and some speculative selling of sterling in New York. However, as the month progressed the rate for spot sterling advanced from $2.80⅜ to $2.81 1/16, the highest level since June 1958. On January 30 the rate stood at $2.81.

There was also a marked pickup in activity in the forward-sterling market. Reflecting some speculative selling pressure, however, the discounts on three and six months' deliveries widened from 5/32 and 5/32 cent to 9/32 and 13/32 early in the month, but subsequently leveled off at about 7/32 and 11/32. At the month end the spread again widened to 9/32 and ½ cent.

Rather persistent interest in certain British stocks firmed the securities-sterling quotation from $2.80 5/16 to a reportedly all-time high of $2.80¾. On January 30 such sterling was quoted at $2.80⅝.

Heavy demand for United States dollars from Canadian commercial interests weakened the Canadian dollar from $1.03 45/64 to $1.03 17/64 during early January. After recovering to $1.03 35/64 on buying by grain interests and some short covering, the quotation moved erratically lower to the month-end quotation of $1.03 1/16. Official intervention to maintain an orderly movement of the rate was in evidence on both sides of the market in Canada.

Trading in the Argentine peso, suspended on December 29 by the Argentine Government in preparation for the introduction of a free market, was resumed on January 12 with the peso quoted at 65 to the United States dollar (or $0.01538 per peso). This compares with the December 29 quotation of 69.25 to the dollar ($0.01444).

Cooperation of Monetary Policy in a Growing Economy

By ALFRED HAYES*

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Today I would like to make a few remarks on the place of monetary policy in the kind of world we live in — a world characterized mainly by rapid change, either evolutionary or revolutionary, both in our own country and in virtually all other nations. Now, unfortunately, there seems to have grown up around the concept of monetary policy an aura of ultra-conservatism, which suggests in the minds of some people that monetary policy is essentially negative, and hence obstructive of the more progressive elements in our society. To my mind this view is wholly misguided. In fact, monetary policy has contributed strongly to economic progress in recent years, and those who have been given the responsibility of shaping monetary policy in this country are genuinely interested in seeing to it that it should continue to be a factor in building a dynamic, viable, and growing domestic and world economy.

Doubtless a principal reason for this unfortunate public image of monetary policy is the degree of emphasis it has necessarily placed on fighting inflationary tendencies. There are critics who accuse the Federal Reserve System, for example, of being so obsessed with inflation that it has neglected equally important objectives in a one-sided effort to achieve price stability at all costs. My reply is that our greatest interest lies in achieving economic growth over a period of years at a sustainable rate, and that our close interest in price stability reflects mainly our belief that any appreciable degree of inflation is very likely to cause speculative distortions and to render unsustainable almost any rate of growth.

I do not mean to imply by "sustainable" that we can expect a completely smooth and steady growth, for some moderate fluctuations are not only probable in a free economy where millions of individual decisions are being made at all times, and where expectations are bound to range widely between optimism and pessimism, but such moderate fluctuations may even be a necessary condition for maximum average growth. Occasional lean periods seem to be necessary to increase incentives to eliminate waste and achieve greater efficiency, and thus to spur productivity. We must be firmly opposed to those superficial appearances of rapid growth which are so unsound as to carry the seeds of severe declines entailing heavy social losses in the form of large unemployment and large unused capacity. It has been argued that a higher rate of growth can be achieved if prices are allowed to "creep" upward. But I think that without this "creep" we are much more likely to avoid excessive spurts and severe declines and thus to attain the best average growth—and it is *average* growth that will count in the long-term competition between the free world and the Communist bloc.

I know of no way of setting a percentage figure on the annual rate of growth we should expect to attain. But it is clearly desirable to set our sights high in the competitive world we live in, always with this major proviso as to "sustainability". To cite specific figures, I cannot feel complacent with unemployment still around the four million mark, with our index of industrial production slightly lower now than in the autumn of 1955, and with per capita real disposable personal income virtually static for the past three years. Even after allowance for the considerable growth in population, dollar figures have given an illusory impression of growth because of the rise in prices.

The social injustices wrought by inflation have been depicted so often and so ably, that I shall pass over this phase of the problem, pausing only to repeat what has been said many times but has not yet sunk into our mentality deeply enough, i.e., that the consumers, the most numerous group in our population, are the least ably represented in political and market arenas. I should like to stress rather the importance of price stability as a cornerstone of growth, both national and international. I have already mentioned the danger that inflationary distortions tend eventually to collapse and to be followed by excessively sharp and severe declines in business activity, as history has demonstrated on many occasions. But there is another aspect we should not lose sight of. Essentially, economic growth depends on the orderly flow of savings into productive investments. There is nothing so likely to interfere with an adequate flow of savings, or to drive savings into unproductive uses, as a public conviction that the dollar will be worth much less after a few years because of erosion of its purchasing power. I am sure that the

* An address by Mr. Hayes before the Thirty-first Annual Midwinter Meeting of the New York State Bankers Association, New York City, January 26, 1959.

huge aggregate demand for capital, arising mainly from the investment programs of the past few years, would have been covered much more easily out of current savings if there had been complete confidence in a stable dollar in the years to come.

Let us consider also the relation of inflation to our vast international obligations. In the kind of world in which we live, a major contribution by the United States to the further development of the less developed nations is vital. Whether this takes the form of public aid or the more desirable form of private investment (and in fact it must include a good measure of both), the successful transfer of resources to carry out this assistance requires above all a cost structure in this country adequately competitive with foreign costs. If the large gold outflow of 1958 brought any benefits to this country (over and above the obvious benefits to international liquidity), perhaps the greatest was to impress on American business at least —and one would hope on American labor also—the fact that foreign competition is growing apace, both abroad and in our own markets, and that we can no longer conduct our affairs, monetary or otherwise, on the comfortable assumption that the international balance of payments is something that foreigners must worry about, but not we Americans. Now that European industries have rebuilt their capacity to supply export markets readily, we must place more emphasis on restraining cost increases and keeping competitive if we are to avoid a loss of jobs to many American workers.

The very fact that as a nation we have learned to cope more successfully than in earlier years with the problems of recession has tended to eliminate the "shake-out" in prices and wages which used to characterize periods of low business activity. Because of this it has been suggested that perhaps we should do less to limit recessionary tendencies. I find myself unwilling to accept that suggestion, with its implication that we must sit by and accept heavy economic and social losses—but certainly the condition I have outlined does point to a much greater need than in decades past for vigilance against sizable average price increases during the upward phase of the business cycle.

I hope you will agree that these various considerations make price stability an extremely important objective in our economy. You would think the case was so clear that all segments in our economy would join forces enthusiastically to achieve it. Yet in fact there has been a deplorable tendency to leave most of the burden to monetary policy—a burden which it is by no means equipped to carry alone. Even many of those who approve highly of monetary policy as a means of "fighting inflation" are all too prone to neglect their own spheres of responsibility where the fight on inflation can and must be effectively waged.

It is little wonder, under these circumstances, that a good deal of the monetary authorities' time and effort has been absorbed by efforts to hold inflationary tendencies in check. For one thing, monetary measures can be taken promptly, and without regard for the clamor of pressure groups; also their effects are probably more general and impersonal than any other type of Governmental control. They can be applied with a minimum of interference with the free market principles on which most of our economy is based. Both law and central banking tradition support a determination on our part to do what we can to protect the dollar's value. Certainly we would very much like to be able to spend less of our time worrying about this objective and to be able to devote more time and effort to promoting more rapid economic growth. The greater the cooperative effort by other elements in our economy to accomplish price stability, the less would be the need for restrictive credit policies.

The current situation is a good example of the kind of dilemma which credit policy is called upon to face. Although recovery is proceeding at a gratifying pace, the existence of very considerable unemployment and excess plant capacity in a good many industries would suggest that our policies should be encouraging further growth in production. On the other hand, while the general price level has shown considerable stability for a number of months, and the near-term outlook is fairly good, the seeds of renewed upward pressures are clearly visible and cannot be ignored. These include the increased liquidity effected in the economy in the past year, the continuing threat of further upward cost-price adjustments, the difficulty of bringing the budget back into balance, and the prevalence of "inflation" psychology as exemplified in the level of stock prices, all of which have led to apprehensions abroad as to what the future may hold for the value of the dollar. Taking all these considerations into account, our problem has been to keep a sufficiently close rein on bank reserves to discourage expectations or fears of inflationary developments in credit and the money supply, and yet to avoid interference with orderly recovery and a resumption of growth.

I believe one of the most effective ways to focus attention on this problem would be to amend the Employment Act of 1946 to provide specifically that preservation of stable value for the dollar is a major economic objective of all branches of the Government. This specific responsibility could not fail, I believe, to focus attention on the

need for better coordination of Federal spending and tax policies, debt management, and credit activities of various other Government agencies. It could provide them a clearer common link with the Federal Reserve System, and with our own credit policies.

Despite the very considerable help which our activities have had from budget surpluses in some recent years, the Federal fiscal position all too frequently has complicated the problem of conducting an effective credit policy. A bias in favor of deficits seems to be inherent in our methods of budget formation, in the inability of the Executive branch to eliminate individual expenditure items from aggregate spending bills, and the lack of any very close tie between the voting of expenditures with the voting of revenues provide the necessary funds. Thus, there is an understandable leaning on the part of the monetary authorities toward economy and restraint in Federal spending.

I should emphasize, however, that it is not for the monetary authorities to presume to decide how the nation should divide the use of its resources between private and public activities. That decision must be made by the people as a whole, both individually, and collectively through their elected representatives. However, it is, I think, quite appropriate for the monetary authorities to urge that, except in unusual circumstances such as a period of recession, whatever public expenditures are decided upon should be covered by taxes or other revenues, and that when boom conditions develop revenues should exceed expenditures. The current effort to produce a balanced budget in fiscal 1960 is a contribution of the greatest importance, not only toward fiscal responsibility, but also to monetary stability.

But it would be far from correct to say that the Federal Reserve System is opposed to useful and necessary public expenditures in themselves, whether for defense, foreign aid, or for such domestic programs as urban and highway improvements, school and housing development, etc. The argument may certainly be made that the nation needs more of such useful public expenditures. The key question is, however: "If the nation wants more of these items, is it willing to give up something in order to pay for them?" In other words, is it willing to shift more of the national resources from private to public use through a heavier tax program? With personal consumption accounting for the great bulk of private expenditures, such a shift would in all probability require a reduction in consumption of privately purchased goods and services through appropriate forms of taxation (unless, of course, the economy as a whole is growing fast enough to permit both public and private spending to expand). The reluctance of the American people to face this choice objectively, and the reluctance of many of our country's leaders to place the choice squarely before them, is one of the most disappointing features of our present economy. We might do well to look at the performance of various European countries, most recently France, where the people have been asked to face similar problems frankly and to make whatever sacrifices are called for in the public interest.

Monetary policy needs allies in the private sector of the economy just as much as it needs allies in the Government. I hope that management and labor are growing increasingly aware of their very real stake in price stability. The practice of restraint in pricing and wage settlements can be of inestimable value in furthering the national interest. As has been said so often in recent years, the granting of wage increases in excess of average productivity gains for the economy as a whole can only lead to the kind of inflationary pressures we are all seeking to avoid. Certainly the rate of improvement in national productivity should be considered an upper limit for the pace of wage increases. The granting of wage rises within this limit would mean that more of the productivity gains could be shared by the consumer, and still permit an adequate return on invested capital, both of which, it can be argued, have a legitimate claim to a portion of the gains. And the holding of wage increases within this limit would check the dilution of the purchasing power of wage earners and retired workers caused by rising costs and prices. While further study is perhaps needed before any figure can be relied upon as this upper limit for annual wage increases (including fringe benefits), it seems much more likely on the basis of past experience that it will turn out to be in the neighborhood of 2 per cent or 3 per cent on average than in the range of some of the major increases sought and achieved in the 1955-57 period. It is, in any case, gratifying that some of the major wage settlements in 1958 seemed to embody less inflationary fuel than those in earlier years. Restraint in wage settlements of course implies a responsibility for corresponding restraint in the price policies of industry.

At this point a word about interest rates may be in order. There is a popular tendency, even among some financial observers, to point to the Federal Reserve System as the arbiter of interest rate levels. Actually the System is operating on the periphery of our vast economic enterprise, exerting a marginal influence, it is true, but one which shrinks into relative insignificance in comparison with the over-all effect of aggregate capital and credit demands and the aggregate flow of savings—or with expecta-

tions of movements therein. This is especially true in the case of long-term rates, since the Fed is not ordinarily a direct participant in long-term securities markets and since the banks' activities in this field are more limited than in the short-term area. But even in the short-term area, the Fed is by no means the only influence, although admittedly it is an important one. Interest rates, in any case, are just symptoms of what is happening to affect the demand for and supply of funds in the various parts of the credit markets.

Above all, I should stress the fact that, while the Fed can modify the natural swings in rates, there are limits beyond which such action can only mean undue expansion of the money supply, if the effort is to prevent a rate rise; or undue credit restriction, if the effort is to prevent a drop in rates. In a free enterprise economy, interest rates are the simplest and most impersonal means of allocating savings among various demands for funds. And in order to have freely responsive rates, we are bound to have fluctuating bond prices, including Government bond prices. All of us would like to damp down the price movements which reflect excessive bond speculation, such as we experienced last summer; but there will always remain a certain range of movement reflecting basic business changes and the public's expectations of such changes. And no apparatus of controls can obscure these basic forces without impeding the adjustment mechanisms that a market economy must have.

Incidentally, the Treasury has certainly made a contribution to sound monetary conditions by demonstrating clearly its willingness to pay going interest rates on its new securities offerings.

I have been speaking purposely in very general terms. We all know that it is sometimes a complex and difficult problem to move from sound general principles to effective day-to-day practices. I would be the first to admit that there is a vast amount we don't know about the detailed techniques of monetary policy—about adequate measures of liquidity, in and out of the banking system, about the effect of varying liquidity upon our own monetary measures, about the extent to which nonbank credit agencies, private and Government, may lie beyond the effective range of our activities. These and many other problems deserve the kind of long-range disinterested study which the Radcliffe Committee is devoting to them in Britain, and which the C.E.D. is endeavoring to initiate in this country.

In the meantime, I fervently hope that as a nation we can achieve more general and widespread understanding of the role which monetary policy is trying to play—of the close interrelationship of our monetary activities and the other economic policies of Government, as well as the policies of management and labor. Above all, what we need is a clearer appreciation of the fact that we are all engaged in a common enterprise, seeking essentially the same inspiring goal of maximum sustainable economic growth and a stable dollar. It is an enterprise in which each of us can be really successful only if we obtain the wholehearted cooperation of the others. The ground I have been over is pretty familiar—but it seemed to me that sound principles are always worth restating. I trust that in the future, as in the past, the banking community can be counted on to do its part to further this common enterprise and to use its position of vantage to create better understanding of these matters in all segments of our growing economy.