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Contents

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The Business Situation

The forward momentum of business activity was apparently maintained in February. Steel output made a striking advance, while strike settlements cleared the way for stepped-up production in several other important durable goods industries. Construction activity was again a source of strength, continuing near-record levels in February. And an important additional stimulus to economic expansion seemed to be coming from business inventory rebuilding after the deep cuts made last year. The near-term price outlook has not changed much; consumer prices were virtually steady in January and wholesale prices, which had risen seasonally in January, tended to ease in the first two weeks of February.

In January, however, as in the preceding several months, there was little improvement in employment or unemployment apart from the usual seasonal developments. Total employment, reported by the Census Bureau, dropped by 1.3 million in January largely because of the customary post-Christmas cutbacks in retail trade and post office jobs and a further reduction in outdoor work. Since September, nonfarm employment (seasonally adjusted) as measured by the Bureau of Labor Statistics has risen at an average rate of about 50,000 per month, only about one-third as much as in the earlier months of recovery. Although manufacturing output increased in January, factory employment declined seasonally; since last September, manufacturing employment has risen only 1 per cent despite the more than 4 per cent advance in factory output. Outside of manufacturing there has been virtually no increase in employment in the past few months. After dropping off somewhat in seasonally adjusted terms in the fourth quarter of last year, nonmanufacturing employment rose in January to about the September level. As measured by the Census Bureau, however, the increase in nonfarm employment over the past four months has been considerably larger. The differences between these two sets of employment data are discussed later in this article.

Since, as usual, most of the temporary holiday jobholders withdrew from the labor force in January, the increase in the number of unemployed persons was less than half the drop in total employment. The rise in unemployment was about average for the month, leaving the seasonally adjusted unemployment rate virtually unchanged at 6.0 per cent, the level near which it has remained since November. Some 230,000 more persons were jobless in January than a year earlier and about 1½ million more than in January 1957, when the unemployment rate was 4.2 per cent. In January, the United States Labor Department shifted eight major labor market areas to categories signifying lower unemployment, but this still left more than half of the nation's 149 industrial centers classified as areas of "substantial labor surplus". The Department also reported that the gains in employment in February and March anticipated by employers in the major labor market areas were generally of modest proportions and partly seasonal in character.

Industrial production continued to advance in January; as in the preceding month, there was a one-point rise in the Federal Reserve Board's seasonally adjusted index. After climbing steadily from its low point last April, industrial production in January was only 1½ per cent beneath the pre-recession level; durable goods production still had recovered only about two thirds of the recession drop, but soft goods output was 4 per cent above its 1957 high. The favorable trend of production was apparently maintained in February. Steel output scored further impressive gains, averaging 84 per cent of capacity during the month, compared with 74 per cent in January. And, in terms of actual tonnage, more steel was produced in February than in any month since May 1957. The demand for steel is reportedly being pushed up mainly by the rush of users to lay in stocks against the possibility of a strike in July, after the steel industry's labor contracts expire. In addition, however, current steel consumption is up and users probably also desire to rebuild their inventories for normal business purposes. Lengthy strikes in the glass and other industries were ended in late January and February, making possible increased production in these lines and also in the auto industry, where production had been curtailed by the lack of glass. The trend of weekly figures for electric power production and freight carloadings also suggested that output was increasing in February.

In January there was a continuation of the rise in consumer incomes that has contributed so importantly to the improvement in business. Personal income climbed to a record seasonally adjusted annual rate of $362.3 billion, $1.6 billion above the previous high reached last November. Retail sales in January, after seasonal adjustment, held at the record December level according to the advance report; at $17.6 billion, total sales of retail stores were 5 per cent higher than a year ago. Automobile sales declined

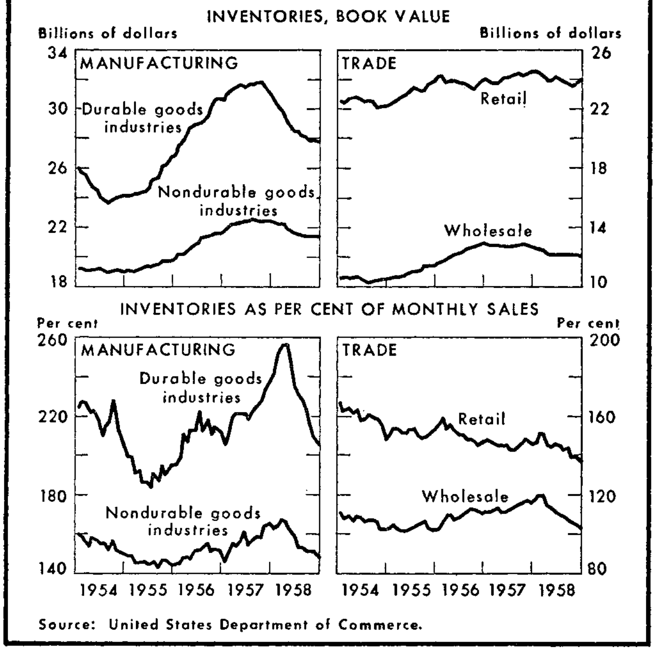


Chart I
BUSINESS INVENTORIES AND SALES
Seasonally adjusted

about seasonally in January, and in the first twenty days of February the sales rate was slightly lower than a month earlier. During the first seven weeks of 1959 some 20 per cent more cars were sold than in the corresponding 1958 period, when the recession was cutting deeply into car buying. But even though this year's models have been faring better than last year's, the recent sales pace seems to imply that the industry's 1959 sales will not be as high as in 1956 and 1957 and will fall far short of the record 1955 level.

Business inventory accumulation seems to have been making an important contribution to the strengthening of demand since the turn of the year. The slowing of inventory liquidation in the second and third quarter of last year and its cessation in the fourth quarter was a powerful factor in the recovery of production. As Chart I shows, total business stocks edged up in the last two months of 1958, chiefly because auto dealers' stocks increased as production of the new models was stepped up. Inventory liquidation at the manufacturers' and wholesalers' level continued in November and December, but the declines were very small. Moreover, by the end of last year inventory-to-sales ratios had declined to a point where businessmen had in the past considered their stocks inadequate. In December the inventory-to-sales ratio in both durable and nondurable goods manufacturing had fallen beneath the level at which producers had begun to rebuild their stocks following the 1953-54 recession. The ratio at the wholesale level was the lowest in three years, and retailers' stocks had not been at such a low level in comparison to sales since their shelves were emptied by the buying spree following the outbreak of the Korean war. Thus, the stage seemed to be set for inventory rebuilding this year. The speed and extent of the rise in inventories will be one of the major factors determining the strength of business in 1959.

MEASURING EMPLOYMENT

With the employment situation still responding only slowly to the strong expansion in business activity, more than usual attention is being accorded to the various statistics of employment. There are two major sets of labor market data, one gathered by the United States Census Bureau and the other by the Bureau of Labor Statistics (BLS). They are collected by entirely different methods and differ significantly in their coverage—and sometimes in their findings. Just as for other economic statistics, therefore, assessment of the employment data requires at times a balancing of apparently conflicting information.[1]

The most comprehensive body of labor force data is that compiled by the Census Bureau in its monthly labor force survey. This is the sole source of statistics for total unemployment, and also a principal source of data for total employment and for many other important aspects of the labor market, including among others the age and sex distribution of the labor force, employment in different occupations, and the amount of and reasons for part-time employment.[2]

Once each month Census Bureau enumerators interview 35,000 households in 330 sample areas of the country. Respondents are questioned as to the employment status of all household members fourteen years of age or over for the calendar week that contains the twelfth of the month. The statistical techniques by which the sample is selected make it possible to calculate mathematically the margin of error involved in estimating national totals from interviews covering only a small proportion of all the households in the country. (Other errors, such as those which might result from inaccurate answers by the respondents, cannot be evaluated mathematically.) For

[1] Responsibility for the analysis and publication of the data is currently divided between the two collecting agencies but is to be shifted wholly to the BLS in July.

[2] The only other major source of unemployment data is the weekly count of the number of persons drawing unemployment insurance published by the Bureau of Employment Security.

unemployment, the chances are about two out of three that the level as estimated for any month, and also the change from the month previous, will be off by no more than 100,000—quite a small error, when it is considered that unemployment has in recent years been in the range of 3-5 million.

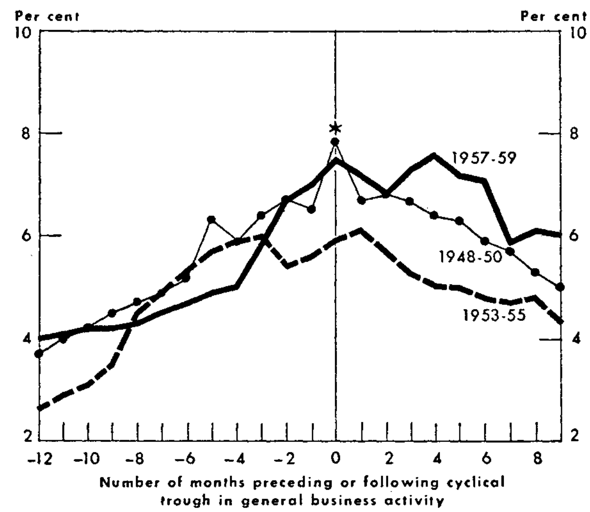
Every person covered by the survey is assigned to one of three possible categories: "employed", "unemployed", or "not in the labor force". A person is counted as *employed* if, during the survey week, he did any work for pay or profit, or worked fifteen or more hours without pay on a family farm or business. With a few exceptions, persons with a job but not at work (due to illness, vacations, labor disputes, etc.) are regarded as employed. A person is considered *unemployed* if he was out of work and states that he was looking for work. However, persons who did not look for work because they believed that no jobs were available in their line or in their community are also counted as unemployed. The sum of all the employed and all those unemployed constitutes the civilian labor force. Other persons, those not at work and not seeking work—housewives, students, retired people—are regarded as ***not in the labor force***.

Of the large body of statistics gathered in the monthly labor force survey, the single figure most widely used by business analysts is probably the seasonally adjusted unemployment rate. This is the percentage of the total civilian labor force that is unemployed, i.e., the percentage obtained by dividing unemployment by the labor force. It must be noted, however, that the seasonal adjustment of this series—indeed, of all the Census labor force data—presents unusually difficult problems that have not yet been satisfactorily resolved. The behavior of the seasonally adjusted unemployment rate during the postwar recessions and recoveries is shown in Chart II, from which it is readily apparent why the concern over the unemployment situation during the current expansion has been so great. Regularly published figures from the monthly surveys show that, like total unemployment, long-term unemployment and unemployment among family heads also have been running higher in recent months than in other comparable postwar periods.

Chart II

THE UNEMPLOYMENT RATE IN THE POSTWAR RECESSIONS AND REVIVALS

Seasonally adjusted



Note: Troughs in business activity, taken from the National Bureau of Economic Research chronology, are April 1958, August 1954, and October 1949.

*Figure for October 1949 inflated because many coal miners, on strike during the month, reported they were looking for other jobs.

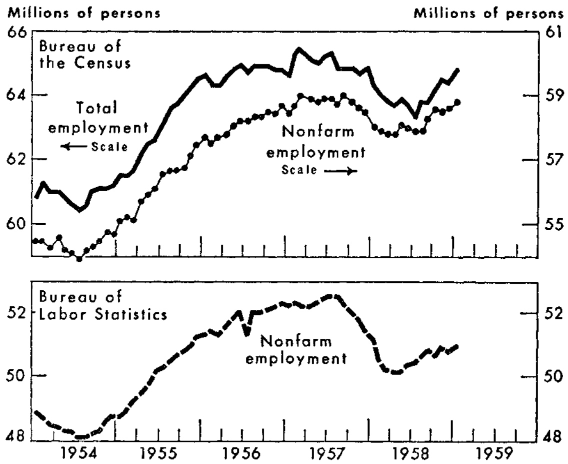
Source: United States Bureau of the Census.

As contrasted with the information for unemployment, the employment data from the Census Bureau surveys are used less frequently in interpreting current trends, mainly because there exists an alternative set of statistics for nonfarm employment, compiled by the BLS, which is much less subject to large irregular fluctuations. While the Census data are obtained through household interviews, the BLS data are compiled entirely from mail reports of payrolls by about 180,000 cooperating establishments. Nonfarm employment as measured by the BLS thus excludes the self-employed, domestic servants, and unpaid family workers, all of whom are included in employment as measured by the Census Bureau. Persons on unpaid absences from work and therefore not on the payroll also would not appear in the BLS data. On the other hand, the BLS employment figures count twice anyone who happens to be on the payroll of two reporting employers. Other differences in coverage between the Census and BLS data for nonfarm employment, while numerous, are of lesser importance. Both series, of course, are eventually "blown up" into estimates representing national totals.

The firms reporting to the BLS are the larger employers in their respective industries; in the aggregate, the participating employers provide about half of all nonfarm wage and salary jobs. Coverage is most complete for government, railroad, and manufacturing employment, and least so for trade and services. Firms report once a month for the payroll period ending closest to the fifteenth. On the same form on which they report employment, it may be noted, cooperating firms also submit the data from which are derived the official estimates of average hours

Chart III

MAJOR INDICATORS OF EMPLOYMENT



Sources: United States Bureau of the Census and Bureau of Labor Statistics.

worked, average hourly earnings, and wage and salary incomes.

Once a year, data become available from a variety of sources giving a complete count of employment for nearly all the employers in each industry. Such "bench-mark" data are used to correct previously published figures (sometimes the revisions are large) and also in carrying forward the current estimates on the basis of the reporting sample.

Largely because the BLS series excludes the more volatile parts of employment, seasonal adjustment is relatively simple. Indeed, the seasonally adjusted series is remarkably free of erratic movements (except when special factors such as major strikes or unusual weather disturbances intervene). In recent years changes of direction in the seasonally adjusted monthly data (if of any magnitude, say as much as 200,000) almost invariably have reflected an underlying change in the general economic situation.

As Chart III shows, the Census Bureau and BLS statistics for nonfarm employment frequently move in opposite directions for short intervals, as might well be expected in view of the differences in coverage and compilation methods. An unusually wide and persistent discrepancy appeared, however, during the 1957-58 recession: BLS nonfarm employment declined by about a million more than Census nonfarm employment. Since the upturn, both series have recovered by about the same amount, so that the gap between the two measures that opened during the recession still exists. Moreover, the discrepancy apparently is not due primarily to the differences in coverage; it remains substantial even when the Census data are adjusted to conform as closely as possible to the narrower BLS definition. While some of the divergence can probably be attributed to such factors as a drop in dual jobholders (who, it will be recalled, may be counted twice by the BLS and only once by the Census Bureau), the major part remains unexplained.

This contradictory behavior complicates the analysis of the present employment situation. In January, for example, total nonfarm employment on the (seasonally adjusted) Census basis was nearly back to the pre-recession peak, while on the BLS basis it was still 1½ million short and in fact no higher than in late 1955. Similarly, the Census figure for total nonfarm employment (without seasonal adjustment) in January was higher than a year earlier, while the BLS figure was lower. Even the more "optimistic" Census series, however, still supports the conclusion that the employment recovery since the business upturn in the spring of 1958 has been significantly slower than during the two preceding cyclical revivals—despite the fact that the current upturn has been the fastest with respect to output and income.

There is also an alternative series to the Census data for farm employment. Farm employment, as estimated by the Census Bureau from the monthly household survey, showed a significant decline during 1958. On the other hand, the alternative series prepared by the Department of Agriculture, based on mail reports and considerably different in coverage, shows no change for 1958. However, because of the variable effects of such influences as weather and school vacations, and because so many farm laborers are not paid in money wages, short-run changes in statistics of farm employment often are not meaningful.

CONCLUSION

Total output and incomes have been expanding strongly so far in 1959. However, even measured by the most "optimistic" data, the accompanying recovery in employment has been disappointing compared with that achieved during the previous postwar business upswings. Unemployment, moreover, is still high for a period in which production is on the verge of, or even at, an all-time peak. A considerable further expansion of demand and output will be required to bring down the unemployment rate to its pre-recession level.

The Money Market In February

The money market remained moderately tight throughout the month of February. The effective rate for Federal funds generally held at the 2½ per cent "ceiling", although at times funds were reported to have traded at rates as low as 1¾ per cent. These brief instances of easing in the money market were chiefly a result of temporary accumulations of reserve surpluses in the New York money market banks at times when the banking system as a whole remained under reserve pressure.

In its refunding in early February of approximately $14.9 billion of maturing securities, the Treasury received subscriptions for only $12.8 billion of new notes and certificates, leaving almost $2.1 billion of the maturing obligations to be redeemed for cash. Principally because of this large cash drain, the Treasury found it necessary to return to the market before the middle of February with a cash offering of $1.5 billion of tax anticipation bills to mature next September. Although the market considered the terms of the Treasury exchange offering attractive, sizable attrition resulted from the fact that a substantial part of the maturing securities was held for near-term cash needs as well as from a widely held impression at the time of the exchange that market rates of interest might soon rise further. In fact, yields on outstanding notes and bonds moved lower over the month, Treasury bill rates fluctuated widely, and the newly issued notes and certificates closed the month at premiums of $^{26}/_{32}$ and $^{8}/_{32}$, respectively.

Table I

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, February 1959

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

Factor	Daily averages—week ended				Net changes
	Feb. 4	Feb. 11	Feb. 18	Feb. 25	
Operating transactions					
Treasury operations*	− 45	+ 73	− 46	− 27	− 45
Federal Reserve float	− 128	− 59	+ 73	+ 90	− 24
Currency in circulation	+ 29	− 72	− 12	+ 94	+ 39
Gold and foreign account	− 19	− 26	− 10	+ 4	− 51
Other deposits, etc.	− 29	− 28	− 87	− 98	− 242
Total	− 194	− 110	− 83	+ 64	− 323
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 121	+ 29	− 98	− 129	− 77
Held under repurchase agreements	+ 81	− 45	− 30	− 1	+ 5
Loans, discounts, and advances:					
Member bank borrowings	− 74	+ 120	+ 30	− 109	− 33
Other	—	—	—	—	—
Bankers' acceptances:					
Bought outright	− 2	− 2	—	—	− 4
Under repurchase agreements	—	—	+ 4	+ 1	+ 5
Total	+ 126	+ 103	− 97	− 237	− 105
Total reserves	− 68	− 7	− 180	− 173	− 428
Effect of change in required reserves†	+ 46	+ 150	+ 66	+ 121	+ 383
Excess reserves†	− 22	+ 143	− 114	− 52	− 45
Daily average level of member bank:					
Borrowings from Reserve Banks	415	535	565	456	493‡
Excess reserves†	353	496	382	330	390‡

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for four weeks ended February 25.

MEMBER BANK RESERVE POSITIONS

System securities operations were almost in balance during February, contrasting with January when seasonal forces tended to expand reserves rapidly and called for sizable net sales from the System Account. Early in February, the System purchased moderate amounts of Government securities outright in order to offset the effect of the contraction of float around the turn of the month and smaller reserve losses from other factors. At this time reserves were also provided on a temporary basis through the extension of repurchase agreements to dealers in order to limit any intensification of tightness in the money market during the Treasury refunding operation. In the latter half of the month, when changes in the other factors affecting reserve positions tended to provide the banks with additional reserve funds, System action withdrew reserves, more than offsetting purchases earlier in the month. Between January 28 and February 25, System holdings of Government securities declined by $96 million: outright holdings fell by $100 million and outstanding repurchase agreements rose by $4 million.

Average net borrowed reserves of member banks rose to $103 million for the four statement weeks ended February 25 from $57 million during January. Net borrowed reserves averaged around $50 million in the first two weeks of the month but increased to $183 million and $126 million, respectively, in the final two weeks.

Week-to-week fluctuations in market factors affecting member bank reserve positions were generally moderate and largely offsetting during February. Required reserves, however, declined steadily over the month in line with seasonal expectations, releasing a total of $383 million in the four weeks, while "other deposits" at Federal Reserve Banks rose in each statement week, withdrawing $242 million over the month. This reserve loss mainly reflected the Treasury payments of interest to the System on its holdings of Government securities.

GOVERNMENT SECURITIES MARKET

Activity in the Government securities market revolved about Treasury debt operations in the first half of February. The books were open on February 2 through February 4 for subscriptions to the new 3¾ per cent one-year certificates of indebtedness and 4 per cent three-year notes offered by the Treasury in exchange for the $9.8 billion of certificates of indebtedness due on February 14 and the $5.1 billion of notes due on February 15. The terms of the exchange offering, which had been announced on January 29, were considered by the market to be attractive. Quotations on "rights" held steady throughout the subscription period at prices of par or slightly lower, while the new 3¾ per cent certificates and the 4 per cent notes were initially quoted on a "when-issued" basis at 99 31/32 (bid). Liquidation of the "rights" was negligible, since investors were reluctant to sell their holdings below par in view of the relatively low prevailing level of rates on bills and other short-term Treasury securities into which the money might be transferred.

After the close of the market on Friday, February 6, the Treasury made known the results of the refunding operation. Holders of $8.9 billion of the matured certificates and $3.9 billion of the matured notes elected to exchange into $11.4 billion of the new 3¾ per cent certificates of indebtedness and $1.4 billion of the new 4 per cent notes. The Federal Reserve holdings had been large, and were, of course, all exchanged. But nearly 23 per cent of the publicly held portion of the maturing securities, or $2,075 million, was retained for cash redemption on February 16. The sizable attrition prompted the Treasury to make an announcement of a cash offering of $1.5 billion of 217-day tax anticipation bills dated February 16 and to mature September 21, 1959, but acceptable at face value on September 15 in payment of income and profits taxes. Payment was allowed up to 75 per cent by credit to Treasury Tax and Loan Accounts. The bills were awarded, in an auction held February 11, at an average issuing rate of 3.293 per cent, about 30 basis points higher than the rate established on a similar Treasury offering last November.

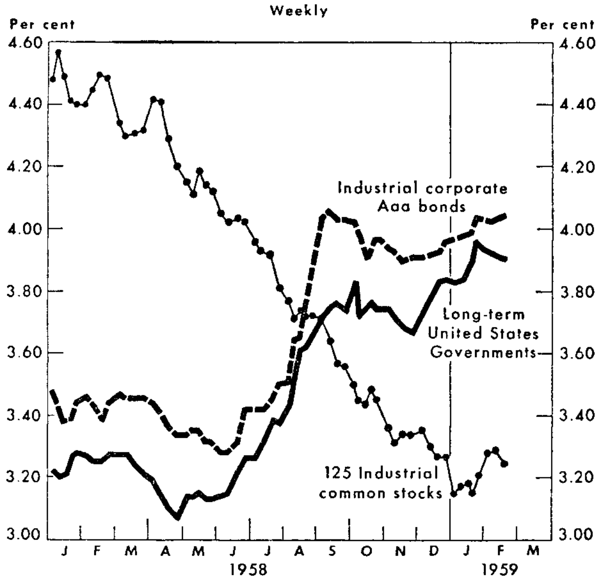
Prices of outstanding notes and bonds drifted lower in the first few days of the month, but reversed their direction after the completion of the Treasury refunding operation. Issues maturing in 1962 through 1972, for which there was some outright investment demand, gained around one point for the month. The price rise in the long-term area was restrained until the closing days of the month, when investment demand for these issues was reportedly stimulated by the recent narrowing of the spread between yields on long-term Treasury bonds and on high-grade corporate bonds. The steadily improving market tone carried quotations on the two new issues involved in the refunding above par soon after the close of the subscription books. At the end of the month, the new 3¾ per cent certificates of 1960 were bid at 100 8/32 and the new 4 per cent notes of 1962 at 100 26/32. The average yield on long-term Treasury bonds declined to 3.88 per cent at the end of February from 3.92 per cent at the close of the previous month.

Treasury bill rates fluctuated widely during February, in response to a number of shifting market influences, but closed the month at about their starting levels. Rates rose early in the month, in adjustment to the favorable coupon rates on the new securities offered by the Treasury in the refunding operation and after the February 6 Treasury announcement of the cash offering of tax anticipation bills. Toward the close of the month, rates were again marked up substantially as offerings increased and dealers experienced some difficulty in disposing of their awards of the issue dated February 26. At other times, however, the prevailing supply and demand situation exerted some downward pressure on rates; most issues were generally scarce during the month and investment demand was fairly strong. This demand was augmented around midmonth as a result of the reinvestment of funds derived from the cash redemption of the unexchanged Treasury certificates and notes.

Bidding in the weekly auctions for Treasury bills was generally aggressive. The three-month bills were awarded at average issuing rates of 2.721 per cent on February 2, 2.810 per cent on February 9, 2.726 per cent on February 16, and 2.589 per cent on February 20, compared with 2.975 per cent in the last auction held in January. The six-month bills were awarded at average issuing rates of 3.107 per cent, 3.326 per cent, 3.253 per cent, and 2.978 per cent on the respective auction dates, compared with 3.337 per cent in the last January auction. The new September tax anticipation bills began trading on a "when-issued" basis at rates as high as 3.35 per cent, somewhat above the issue rate, but the market rate subsequently dropped to close the month at 3.18 per cent. On February 26 the Treasury announced that $1.5 billion of the three-month bills and $400 million of the six-month bills would be offered in the March 5 auction to replace the $1.8 billion of maturing bills. This is the first regular weekly

YIELDS ON COMMON STOCKS, CORPORATE BONDS AND LONG-TERM U.S. GOVERNMENT BONDS

Weekly



Sources: Board of Governors of the Federal Reserve System and Moody's Investors Service.

bill sale since mid-January in which additional cash will be raised by the Treasury.

OTHER SECURITIES MARKETS

Flotations of municipal bonds expanded to an estimated total of $790 million in February from $525 million in January. Thus, the volume of new issues was only slightly below the February 1958 all-time calendar-month record of $825 million.

In contrast to the municipal market, new issue activity in the corporate market was at a low ebb in February. Bond flotations for new capital purposes totaled an estimated $185 million, compared with $375 million in January and $390 million in February 1958. Although the volume of corporate bond issues was relatively small during the month, and represented a much sharper decline from the previous calendar month than had occurred in February 1958, issues of common stock by corporations totaled an estimated $130 million, compared with $100 million in January and $75 million in the corresponding year-ago period. Nearly half of the total bond issues sold during the latest month, moreover, are convertible into stock.

Common stock issues amounted to 36 per cent of total corporate financing in February, slightly higher than the 29 per cent average for the most recent five months and nearly three times the 13 per cent average for the period August 1957 through September 1958. The marked shift from bond to equity financing that occurred in the last quarter of 1958 followed the sharp increase in common stock prices in 1958 and the simultaneous increase in market yields on corporate bonds. Since August 1958 high-grade corporate bonds have provided a better return than representative average yields on common stocks (see chart). This same relationship had last prevailed, and then only briefly, in mid-1957.

The markets for seasoned corporate and municipal bonds were generally firm during February. The average yields on Moody's Aaa-rated seasoned bonds declined over the month from 4.16 per cent to 4.13 per cent for corporates and from 3.20 per cent to 3.11 per cent for municipals.

On February 4 commercial paper dealers reduced their rates by ⅛ of 1 per cent, offsetting a similar increase in January. The rate on prime 4- to 6-month maturities is again 3¼ per cent. On the last day of the month the major finance companies revised their rates and maturity categories. The rates on directly placed paper are now

Table II

Changes in Principal Assets and Liabilities of the Weekly Reporting Member Banks

(In millions of dollars)

Item	Statement week ended: Jan. 28	Feb. 4	Feb. 11	Feb. 18p	Change from Dec. 31, 1958 to Feb. 18, 1959p
Assets					
Loans and investments:					
Loans:					
Commercial and industrial loans	− 141	− 111	+ 4	+ 91	− 1,135
Agricultural loans	+ 2	− 10	− 2	− 4	− 40
Securities loans	− 60	− 112	− 106	− 34	− 558
Real estate loans	+ 9	+ 20	+ 34	+ 10	+ 128
All other loans (largely consumer)	− 7	+ 19	+ 18	+ 6	− 38
Total loans adjusted*	− 198	− 195	− 53	+ 69	− 1,676
Investments:					
U. S. Government securities:					
Treasury bills	− 48	− 1	− 140	+ 399	+ 47
Other	− 116	− 171	− 259	− 745	− 732
Total	− 164	− 172	− 399	− 346	− 685
Other securities	− 56	+ 51	− 117	+ 41	− 155
Total investments	− 220	− 121	− 516	− 305	− 840
Total loans and investments adjusted*	− 418	− 316	− 569	− 236	− 2,516
Loans to banks	+ 221	− 53	− 64	− 61	+ 806
Loans adjusted* and "other" securities	− 254	− 144	− 170	+ 110	− 1,831
Liabilities					
Demand deposits adjusted	− 572	−1,080	− 30	− 829	− 2,364
Time deposits except Government	− 1	− 10	− 142	+ 45	− 179
U. S. Government deposits	+ 358	+ 97	− 455	+ 594	+ 164
Interbank demand deposits:					
Domestic	− 518	+ 549	− 206	− 73	− 1,981
Foreign	− 41	+ 3	+ 61	− 27	− 146

p Preliminary.

* 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.

uniform among the major companies, ranging from 2½ per cent for 30- to 59-day maturities to 3¼ per cent for 180- to 270-day paper.

MEMBER BANK CREDIT

Total loans and investments, adjusted, of all weekly reporting banks fell by $1.5 billion over the four weeks ended February 18, with a $1,162 million reduction of securities holdings and a $377 million decline in loans. The drop in total loans stemmed from decreases of $312 million in securities loans and $157 million in business loans, which were partly offset by moderate increases in both real estate and consumer loans. Over the four-week period, the banks sold off or redeemed $1,291 million of Treasury issues other than bills and reduced their portfolios of corporate and municipal securities by $81 million, but purchased an additional $210 million of Treasury bills.

The reduction in securities holdings in recent weeks continues the tendency, since the movement away from credit ease last August, for the weekly reporting banks to sell off Government securities (mainly bonds and notes), a tendency interrupted only temporarily during periods when these banks acquired large blocks of new Treasury issues which were subsequently sold to others. Since early August 1958, weekly reporting bank holdings of Government securities have declined by $3.0 billion while total marketable Treasury debt has risen by about $13 billion. Although other commercial banks have increased their holdings of Government securities over this period, the larger part of the increase in marketable debt has been lodged with nonbank holders attracted by higher yields.

EARNINGS AND EXPENSES OF SECOND DISTRICT MEMBER BANKS IN 1958

An analysis of the earnings and expenses of Second District member banks in 1958 will be available on March 16, 1959. Requests should be directed to the Publications Division, Federal Reserve Bank of New York, New York 45, N. Y.

International Monetary Developments

INTERNATIONAL FINANCIAL MARKETS

The advent of convertibility and the greater confidence in Western European currencies, which this development has engendered, have focused attention on recent international movements of investment capital. International capital movements had already been stimulated to some extent by the trend of interest rates in leading financial centers over the past fifteen months. As interest rates in these centers have moved variously in response to changes in domestic economic conditions or in international reserves, differences in the timing and the extent of such changes have altered the rate relationships among the respective countries. Although interest rate considerations are not the only factor underlying international movements of capital, the shifting rate differentials of the past year or so have encouraged an increase in such transfers.

Foreign and international securities flotations in the United States were unusually high in the first half of 1958, a period of relatively low interest rates in this country; for the year as a whole, such flotations were larger than in any previous postwar year and more countries were represented among the borrowers. Among the borrowers of the past fifteen months were some, like the city of Amsterdam, that had never before approached the United States capital market, and others, like Austria, Japan, and the city of Oslo, that had not borrowed here since before the war.

On the Continent, the most significant developments of the past year have been the reopening of the Swiss capital market and the re-emergence of Germany as an exporter of long-term capital. As a result of the easing of capital market conditions, the Swiss authorities last fall permitted again the flotation of foreign issues on the Swiss market; such issues had been suspended two years earlier, following the Suez crisis, when a rapid succession of domestic power-development loans had contributed to considerable capital market tightness. The reopening of the market has resulted in flotations there by such traditional borrowers as the International Bank and the Union of South Africa, as well as by a United States corporation. Announcement also has been made of an issue to be placed in Switzerland by a British corporation, the first major instance of borrowing by a British firm in a foreign capital market since the war.

In West Germany, the authorities have been trying for a number of years to broaden the capital market. This goal has been supported by the central bank's discount rate policy, which has aimed at lowering the over-all

German interest rate level with the express intention of widening sufficiently the yield differential between Germany and other countries so as to stimulate the outflow of private capital. Not only was the placement of private short-term funds abroad resumed in late 1957, but a modest beginning in the direction of long-term lending to foreigners was made last September when a South African corporation floated a loan on the German capital market, the first foreign industrial bond issue to be placed in Germany since before World War I.

At the same time, capital markets on the Continent also have tended to become more closely interconnected. Following the South African bond issue, an Austrian power loan was floated in Germany early this year, the first postwar Austrian issue to be placed exclusively in Germany. German banks and other financial institutions are readying themselves, moreover, to invest more heavily in leading industrial shares of other Common Market countries. A number of new investment trusts have also been formed in Germany and Switzerland, which will take up shares of companies in Common Market and other European countries. In addition, shares of major Common Market firms are increasingly being listed on the stock exchanges of other member countries.

In the international money market, the incentive has increased for the international movement of funds seeking the most renumerative investment outlets. The pattern of money market rates during 1958 was generally such as to favor the movement of foreign funds—United States, as well as French, German, and Swiss—to the London market for short-term investment. More recently, some funds have also moved to the United States and Canada, as interest rates in these markets have risen. The profitability of such movements depends, of course, not only on the interest rate differentials between the respective centers, but also among other things on the relationship of the particular currencies in the spot and forward markets. During 1958, the discount on forward sterling in terms of the dollar did not fully offset the interest rate differential, and a slight incentive existed during most of the year to move dollar funds to London.

While interest rate considerations, as already pointed out, are by no means the sole determinant of the migration of capital between markets, the trend of rates during the past fifteen months has been such as to encourage such flows. Following world-wide increases over a period of two to three years, interest rates declined in almost every country during the first half of 1958. The declines, which in some cases had begun in late 1957, reflected the adjustment of money and capital markets to the abatement of inflationary pressures, to the decline in economic activity, to the accompanying easing of monetary policies, and in most Western European countries to the rise in international reserves.

After mid-1958 the pattern became considerably less uniform. In some countries, notably in the United States, rates turned upward once more as economic recovery got under way. However, in other countries the decline in rates that had characterized much of last year continued into 1959. Particularly large declines in short-term yields took place in Germany, the Netherlands, and the United Kingdom; in February, Treasury bill rates in both Germany and the United Kingdom were the lowest in four years. Long-term yields have fallen appreciably in Belgium, Germany, Switzerland, and the United Kingdom, with current yields on British Consols the lowest since early 1957.

EXCHANGE RATES

Activity in the New York foreign exchange market tended to slacken during February, in part because of the strong competition of the London and Continental exchange markets. In order to make the New York market more competitive with these other centers, brokers adjusted, effective February 24, their charges on transactions in sterling and most Western European currencies. The effect was to narrow the spreads between the buying and selling rates for these currencies in the New York market. A by-product is the quoting of those rates of exchange on a decimal basis instead of fractionally as heretofore.

Spot sterling, after advancing slightly to $\$2.81\frac{1}{8}$ on February 5, generally turned lower as commercial demand eased somewhat, with the quotation reaching $\$2.80\frac{13}{16}$ by February 16. Subsequently, as some commercial demand developed, the rate rose to about the $2.81 level. On February 24, reflecting the new system of quoting, spot sterling was quoted on the offered side of the market at $2.8104, the bid side being four points lower at $2.8100. At the month end, spot sterling was quoted at $2.8099.

The forward-sterling market reflected the reduced activity in the spot market. Three and six months' forward sterling were at their widest spreads of $\frac{9}{32}$ and $\frac{15}{32}$ cent, respectively, at the beginning of February. Thereafter, as the market anticipated a reduction in the British bank rate, the discounts narrowed to $\frac{1}{8}$ and $\frac{1}{4}$ cent on February 10. With the British bank rate remaining unchanged at 4 per cent, the spreads on forward deliveries again widened and, following the new method of quoting sterling, were at discounts of 31 points and 45 points, equivalent to 0.442 and 0.321 per cent per annum, respectively, at the month end.

Securities-sterling quotations fluctuated in the narrow range of $2.80½ to $2.80¾ in a quiet market, the rate on February 27 being $2.80¼.

The Canadian dollar quotation moved erratically downward during the first half of February. The lack of substantial commercial demand for Canadian dollars, reduced interest in Canadian investments, and the absence of new Canadian financing in the New York market combined to reduce the quotation for the Canadian dollar from $1.03 at the beginning of February to $1.01⅞ at midmonth, the lowest since February 1958. Subsequent offerings of United States dollars by Canadian paper companies, the covering of short Canadian dollar positions in the New York market, and some movement of short-term funds to Canada firmed the quotation to $1.02 47/64 at the end of February. Official intervention to maintain an orderly movement of the rate was again evident in the Canadian market.

Toward a Stronger International Payments System

The past year witnessed a marked improvement in the international liquidity of industrial countries abroad and a strengthening of the international payments system in general. The apprehensions of only a year ago that the United States recession would necessarily lead to a severe and general international payments crisis did not materialize. On the contrary, foreign countries, on balance, gained gold and dollars from the United States, and primarily because of these gains their hard currency reserves increased by record amounts. Greatly improved reserve positions in turn made possible the year-end move toward convertibility in Western Europe, which made the currencies involved more useful for both trading and reserve purposes and opened the way for a further dismantling of discriminatory trade controls.

Developments last year in many primary-producing countries, it is true, cast a shadow over the world financial scene. In most of these countries, balance-of-payments problems that were already difficult became exacerbated by the continued weakness of world commodity prices and by the persistence of internal inflationary pressures. In many cases, however, the payments difficulties were temporarily alleviated by large-scale foreign credits. Moreover, by the turn of the year some commodity prices were somewhat above their 1958 lows. In 1959, the international liquidity positions of the primary-producing countries, as well as of the free world as a whole, would benefit from the proposed increase in the resources of the International Monetary Fund and the International Bank.

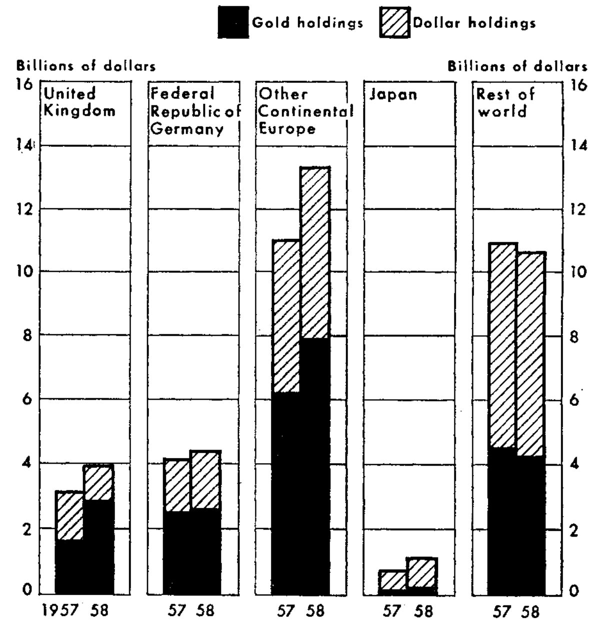
THE RECORD RISE IN FOREIGN GOLD AND DOLLAR HOLDINGS

The record rise of some $4.1 billion in foreign gold and dollar holdings[1] during 1958 carried the total to some $36.8 billion, or over twice the postwar low of June 1948. About $3.1 billion of the year's increase was accounted for by gold alone; of this, $2.3 billion was obtained through purchases from the United States Treasury—mostly by Western Europe—and some $800 million from new production outside the United States, from Russian gold sales, and from other foreign sources.

The reserve gains were particularly large for the Western European countries (Chart I). These gains reflected both the considerable lessening of inflationary pressures in these countries and the interrelated sharp shift in the terms of trade in their favor as a result of the fall in commodity

Chart I

GOLD AND DOLLAR HOLDINGS OF FOREIGN COUNTRIES



Note: Holdings include official gold reserves and official and private dollar holdings (primarily bank deposits, United States Government securities, and bankers' acceptances).

[1] "Gold" comprises the reported or estimated official gold reserves of foreign countries (excluding Soviet Bloc countries and Mainland China) and of international institutions. "Dollar holdings" comprise both official and private holdings, and consist primarily of sight and time deposits, short-term United States Government securities, bankers' acceptances, and estimated holdings of United States Government notes and bonds. Detailed data on foreign gold and dollar holdings are regularly reported in the *Federal Reserve Bulletin.*

prices. The further gains in reserves recorded in the first two months of 1959 appear to be evidence of initial success in meeting the test of nonresident convertibility.

Total British gold and dollar holdings increased $837 million in 1958, despite the year-end repayments of $188 million on the postwar United States and Canadian loans. The sustained growth of British holdings in the past seventeen months has, of course, highlighted the remarkable improvement in the United Kingdom's external financial position since the confidence crisis of the summer of 1957. The United Kingdom had a record current-account surplus on its balance of payments last year, and also benefited from a reversal of the 1956-57 speculative outflow from sterling into the dollar and the German mark. While the overseas sterling area ran a current-account deficit with nonsterling countries, its deficit was largely offset by a capital inflow from the United States and credits from international institutions.

No less impressive has been the strength shown by the balance of payments of Continental Western Europe. That area accounted for some two thirds of the year's total gold and dollar increase, with gains by Belgium, Germany, Italy, and the Netherlands ranging from $300 million to $450 million. Most dramatic, however, was the turnabout in France's external financial position. During the first half of the year, the country's reserves continued to decline, despite substantial foreign credits. In the second half, however, it began to gain sizable amounts as its trade position improved and a reflux of capital developed. There was a temporary setback toward the end of the year, when rumors of the impending franc devaluation set off a large outflow of funds from the franc. This outflow, however, was quickly reversed after the year end, following the 15 per cent devaluation and the adoption of sweeping fiscal and other stabilization measures. In early 1959 French reserves were apparently increasing rapidly.

Canada and Japan also gained substantial gold and dollar reserves, in response to reduced trade deficits. In the case of Canada, the capital inflow from the United States, although less than in 1957, continued relatively high.

In contrast to the reserve gains in most industrial nations, the gold and dollar holdings of primary-producing countries as a whole declined last year; in addition, primary-producing countries in the sterling area drew on their sterling balances. The decline in reserves, moreover, might well have been greater, because of these countries' greatly increased current-account deficits, had they not obtained sizable credits from international financial institutions and United States Government lending agencies.

THE UNITED STATES BALANCE OF PAYMENTS AND INTERNATIONAL LIQUIDITY

The greater part of the reserve gains of foreign countries in the aggregate last year arose from transactions with the United States. While United States payments exceeded receipts by record amounts in 1958, a net outflow of gold and dollars from the United States is by no means exceptional. Indeed, in each of the past eight years aside from 1957, total outpayments by the United States substantially exceeded its receipts, thus contributing importantly to the easing of the dollar shortage, the rise in foreign reserves, and consequently to the expansion and liberalization of world trade.

That last year's outflow from the United States was larger than previous ones was due both to continued high payments to foreigners and to a rather sharp decline in receipts from abroad. In contrast to previous United States recessions, imports were well maintained in 1958, declining only about 2 per cent from 1957. Raw material imports decreased somewhat in value but by less than might have been expected in the light of the decline in United States production; much of the cutback in domestic demand for raw materials appears to have fallen on domestic producers rather than on imports. Moreover, imports of certain manufactured products—notably automobiles—actually increased substantially over 1957.

As regards other United States payments, there was a moderate rise in military expenditures abroad, and in outlays for travel and other similar invisible transactions. New United States private direct investment in foreign countries declined from the record levels of 1957, the reduction reflecting to a large extent reduced investment in the Venezuelan petroleum industry and in Canada from the unusually high level of the preceding years. This decline, however, was partly offset by a rise to record levels of foreign bond flotations on the American capital market (in part induced by the relatively low United States interest rates early in the year) and by some increase in the outflow of United States Government capital. Altogether, total United States outpayments for imports and other transactions amounted to some $26.6 billion during 1958, as against $27.2 billion in 1957.

Total United States receipts in 1958, from the export of goods and services, foreign investment in United States industry, and other sources, on the other hand, declined to $23.3 billion from $27.7 billion in 1957, largely as a result of a 16 per cent decline in merchandise exports (excluding exports under the military-aid program). As a combined result of the small decline in United States outpayments and the drop in United States receipts, foreigners received about $3.3 billion more from the United States than they spent for United States goods and services. Of this amount, some $2.3 billion was used to purchase gold from the United States, as already noted.

UNITED STATES EXPORTS AND GOLD STOCK DECLINE

The decline in the United States gold stock, together with the sharpness of the cutback in United States exports in 1958, has given rise to some concern over the external strength of the dollar and has led to assertions that United States products were pricing themselves out of the world market. While some of these apprehensions seem to have been exaggerated, in the light of the more detailed analysis below, the events of 1958 did bring into sharper focus a number of developments that have been slowly gathering force over the past several years.

The export decline, in terms of over-all magnitudes, represented little more than a return from the abnormally high 1957 levels to the lower but still substantial 1956 levels. United States exports in 1957, it will be recalled, had been swollen by the temporary closing of the Suez Canal, as well as by poor harvests in Western Europe and elsewhere, which resulted in large United States petroleum and agricultural exports. Moreover—and this probably has been the most important single factor in last year's export decline—the business boom and the accompanying inflationary pressures that had characterized the economies of Western Europe, Canada, and Japan through much of 1957 tapered off and were followed in 1958 by some slackening in business activity. Sales of raw materials, fuels, and capital equipment, both domestically and abroad, of course, are always particularly sensitive to changes in economic activity. It was, therefore, to be expected that the demand of the industrialized nations for such commodities, from the United States or from other sources, should contract with a decline in economic activity and a shift from inventory accumulation to inventory liquidation.

It is nevertheless true that in recent years the prices of manufactured products appear to have risen more sharply in the United States than in such competing countries as the United Kingdom and Germany. The fact that these differences were not noted as deterrents to United States exports until recently, however, suggests that there may have been other offsetting factors which had obscured these differentials for some time. By 1958 many of the factors which had, in effect, shielded domestic products from the full effects of international price competition were turning around. Marked gains had been made in the foreign competitive position through greater availability of products for export, shorter delivery periods, more attractive credit terms, improved quality or design of products, and better servicing facilities. The United States thus no longer has the dominant position on the world market that it had in earlier postwar years when this country alone was able to provide large-scale exports of many types of products. The revitalization of foreign economies that this change reflects has been one of the principal aims of United States postwar foreign economic policy and indeed has, to a substantial extent, been financed by United States aid.

These developments may also be having some effect upon the investment behavior of American concerns doing business on an international scale. Though not clearly discernible in the balance-of-payments statistics for 1958, such influences may help to explain the widespread sensing of an emerging "unfavorable" comparison between this country and others with respect to trading prospects in the future. Wage rates had for generations been higher in this country than abroad. The offset had always been our greater productivity per man—the result of larger capital investment, better engineered facilities, a more versatile labor force, and economies of large-scale production. The aim of foreign direct investment, with the partial exception most notably of some of the extractive industries, has been primarily to widen access to foreign markets, often still protected from the competition of United States products. But as technology and labor skills in many countries become similar to our own, with some costs here substantially higher than abroad, the incentive may become stronger for American industry to broaden its investment base overseas—to consider devoting a little more of its capital budgets to expansion abroad, a little less to expansion or modernization at home. Industry located abroad, of course, also faces the problem of rising costs. Nevertheless, it is clear that industry in the United States must henceforth learn to live with considerably more intense foreign competition. Meeting this competition successfully will call for greater efforts to develop new products and improve production techniques. It will also require moderation in the price policies of industry and in wage demands by labor. Barring such efforts and restraint, particularly with capital as well as merchandise becoming increasingly mobile between countries, there is indeed a risk worth pondering that some elements in the American economy may at least tend to price themselves out of the expanding markets overseas.

Last year's decline in United States gold stock, however, can in no sense be regarded as a run on the dollar. The decline, it is true, was in contrast to recent years when the bulk of foreign dollar gains was invested in dollar assets, rather than used to purchase gold from the United States Treasury. But most countries financed their 1958 gold purchases by newly gained dollar balances rather than by the liquidation of existing assets, and, as already noted, foreign countries also continued in the aggregate to increase their dollar holdings by still another $1 billion.

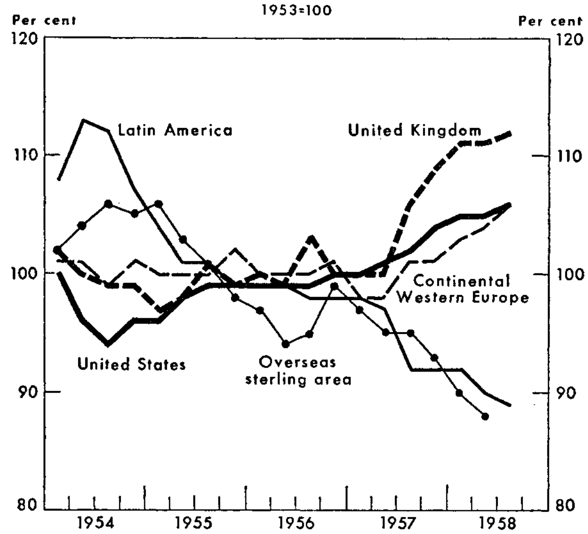
Indeed, last year's heavy gold purchases by foreign countries can largely be explained not only by the over-all United States international payments deficit, but also by the fact that the foreign reserve gains were concentrated in the Western European countries—the very countries that as a group traditionally maintain a large part of their international reserves in gold rather than in United States bank deposits or United States Treasury securities. At the same time, there was a decline in the reserves of the less developed countries, which normally hold a high proportion of their reserves in the form of dollar assets.

At $20.6 billion, the United States gold stock still represents somewhat over half of the total official gold holdings of the free world, and exceeds by over $8 billion the statutory 25 per cent gold cover required against the note and deposit liabilities of the Federal Reserve System. The primary function of gold in the world today is for the settling of balance-of-payments differences among countries, and the United States continues to have far more than enough gold for any foreseeable magnitude of such need.

Chart II

TERMS OF TRADE OF SELECTED COUNTRIES AND AREAS

1953=100



Note: The terms of trade indexes are derived by dividing average price indexes for exports by average price indexes for imports.

SHIFTS IN THE PATTERN OF WORLD TRADE

The pattern of foreign gold and dollar reserves was also significantly affected last year by transfers among foreign countries. Foreign industrial nations, such as the United Kingdom and Germany, thus gained substantial gold and dollar reserves in 1958 through transactions with other foreign areas as well as with the United States. The balances of payments of these industrial countries benefited greatly from the decline in the price of imported raw materials, and the resulting sharp favorable shift in their terms of trade (see Chart II), as already noted. This price movement led, conversely, to a deterioration in the payments positions of the primary-producing countries. Of the $2.7 billion rise in Western European gold and dollar holdings last year, only about half was due to transactions with the United States, most of the balance having been gained from primary-producing countries. The primary-producing countries, in turn, partly offset their losses to foreign industrial nations by gaining a moderate amount of reserves from their transactions with the United States.

This pattern of reserve transfers reflected fairly faithfully the changes that occurred in the pattern of world trade last year. On the one hand, as previously noted, United States raw material imports were generally well maintained. On the other hand, Western European imports from primary-producing countries apparently dropped by at least 10 per cent—with a particularly marked decline in imports from Latin America—while Western European exports to primary-producing countries declined very slightly, if at all.

The decline in the value of Western European raw material imports last year was partly attributable to the reduction in demand that accompanied the moderate decline in Western European economic activity and, more importantly, to the weakness in world commodity prices. This weakness was undoubtedly aggravated by the decline in economic activity both in the United States and in other industrial nations and also, in the case of aluminum and tin, by Soviet sales on world markets. However, these developments were by no means the only source of the pressure on the commodity markets. The expansion in raw material productive capacity that had begun in the early fifties began to be fully felt only about 1956. The increased supplies that then appeared, at a time of declining demand and the curtailment of government stockpiling in the United States and elsewhere, tended inevitably to depress world prices.

The present international payments problems of primary-producing countries are not, however, due solely to lower exports receipts. Many of these countries have embarked on ambitious development programs to raise incomes and living standards from their extremely low levels. This goal is, of course, highly desirable. However, the domestic financial and monetary policies adopted in carrying out these programs have not always been such as to prevent inflationary excesses, and these excesses have tended to find their counterpart in high imports.

INTERNATIONAL LIQUIDITY, CONVERTIBILITY, AND THE INTERNATIONAL MONETARY FUND

The remarkable economic recovery and expansion of Western Europe since the end of World War II was dramatically highlighted at the year end by the Western European moves to introduce nonresident convertibility for current transactions. The formal commitment to convert these currencies directly into dollars at the official rates has raised their status, and has made them more desirable not only as trading currencies but also as reserves, thereby in effect adding to international liquidity. The convertibility measures, moreover, may lead indirectly to a further liberalization of world trade. Since imports of these countries, as well as the imports of third countries payable in the new convertible currencies, will now in effect involve a potential gold and dollar cost, discriminatory controls on dollar imports are no longer logical from a balance-of-payments viewpoint. Such discriminatory controls as well as other import restrictions do, however, serve to protect domestic industries.

The international financial system will also be strengthened if the proposed increase in the resources of the International Monetary Fund and the International Bank for Reconstruction and Development is approved. A prime function of the Fund is to provide financial assistance to member countries in order to help them stabilize their currencies, maintain or move toward convertibility, and overcome temporary balance-of-payments problems while avoiding policies harmful to national or international prosperity. Access to the Fund's resources thus provides its members with a second line of reserves.

A substantial part of the Fund's gold and dollar resources, however, is now committed through drawings or stand-by credits. Moreover, there has been a large increase in world trade since the member quotas were set in 1947. For these reasons, and as a means of increasing international liquidity generally, the governors of the Fund and the International Bank have approved the United States proposal to increase these institutions' resources. This proposal, which remains subject to approval by the legislatures of the member countries, provides for a general increase in quotas that would add the equivalent of $5.1 billion to the Fund's resources and double the Fund's gold and United States dollar holdings from their current level of $2.3 billion to $4.6 billion. The liquid resources of the Fund have also, in effect, been increased by the Western European convertibility measures; with European currencies now almost fully convertible, there is little reason why a greater proportion of the drawings on the Fund should not be in currencies other than the United States dollar.

The capital of the International Bank would be increased by $11 billion, from $10 billion to $21 billion. No cash payments on the new subscriptions, however, are to be made to the Bank at this time. The new subscriptions are to remain subject to call, and will be made only when they are needed to meet obligations arising from the Bank's borrowing and from its guarantees of loans made by other investors.

CONCLUSION

Further progress was thus realized in the past year toward the sound and expanding international economy that has been a major goal of United States postwar economic policy. The lessening of inflationary pressures in the industrial countries, the improvement in international liquidity, and the elimination by many of the major trading countries of many of the remaining controls on international payments have all provided a stronger base for a further expansion of world trade and the free world economies.

Many of the less developed countries, however, continue to be confronted by the very difficult problem of extremely low incomes and savings and rapidly rising populations. The continued weakness of world commodity markets accentuated these countries' difficulties last year, and tended to widen the gap between them and the industrialized economies of the West. By now, however, Western Europe is economically strong enough to take a larger part in a much needed cooperative effort to help the less developed countries to raise their very low living standards.