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The Business Situation

The steel strike, and to a lesser extent the strikes in other metal industries, increased their hold on the economy in August and September, pulling production and employment appreciably below the record midyear levels. At the same time, underlying consumer and business demands appear to have remained strong, lending support to the view that settlement of the strikes will be followed by a marked rebound in business activity.

IMPACT OF THE STRIKES

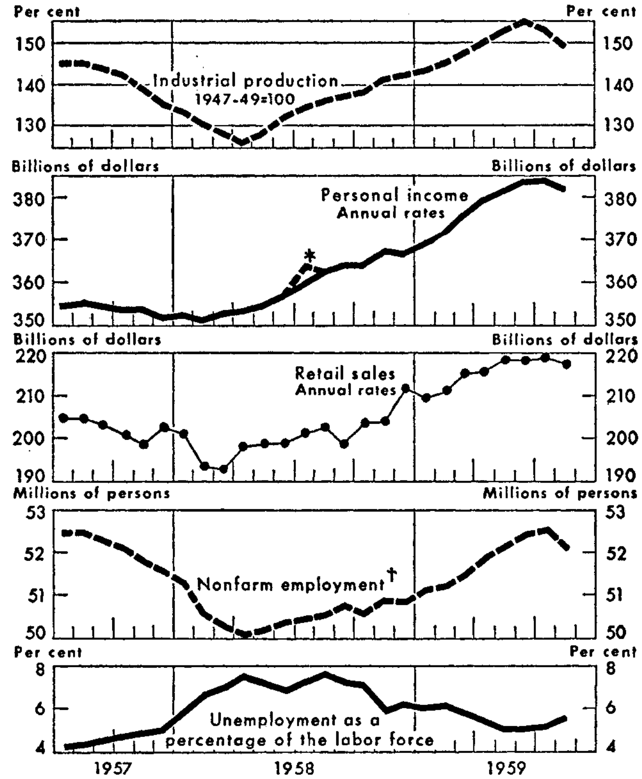
Thus far, the main effect of the steel, copper, and other metal strikes has been to curtail output in the strike-bound industries themselves and in closely related mining and transportation activities. Since most metal-using firms had amassed large inventories prior to the strikes, only a few companies experienced shortages in August. More firms were pinched for supplies in September, but the over-all impact of the shutdowns still did not appear to be large. It is widely reported that by the end of September, however, many more steel-using concerns were nearing the point where sizable cutbacks will be required if the strike is not settled quickly. Indeed, some stringency is expected even in the event of a quick settlement as it may take several weeks to restore high production rates and refill distributive pipelines. Reports of substantial premium prices being paid for certain types of steel are further evidence of the growing scarcity. Steel output at the plants not affected by the strike, remaining at about 1½ million tons in September, together with imports which have been running at about 400,000 tons monthly, have met only a fraction of current needs; stocks have been drawn down at an estimated monthly rate of around 5 million tons from the 24-million-ton level reportedly held on the eve of the strike. Supplies of copper and other nonferrous metals affected by strikes are generally reported to be in better shape than steel, with no serious shortage in the immediate offing.

The deepening effect of the metal strikes may be seen in Chart I. In July, with the steel strike beginning halfway through the month, the industrial production index fell by 2 points (about 1 per cent) from the record June level of 155. The effects of a sharp drop in primary metals output and sizable cuts in mineral production were in good part offset by continuing gains in most other manufacturing lines. Personal income, retail sales, and nonfarm employment—also shown in Chart I—continued to rise in July.

Chart I

SOME ECONOMIC INDICATORS

Seasonally adjusted



*Reflects payment of retroactive salary increases to Federal Government employees.

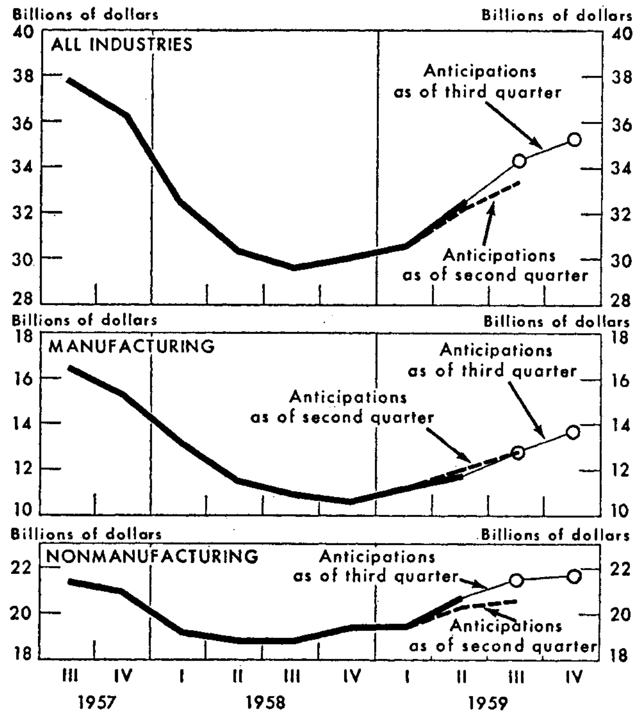
† United States Bureau of Labor Statistics series.

Sources: United States Department of Commerce and United States Bureau of Labor Statistics.

In August, with the steel strike in effect for the entire month and output of other metals also curtailed, the industrial production index fell by another 4 points (nearly 3 per cent) to 149 per cent of the 1947-49 average. Output of primary metals dropped sharply further, while metal users began to feel some impact, too; output of fabricated metal products dipped by 4 per cent from the July level. Production of machinery and transportation equipment also decreased in August, following increases in the first seven months of this year, although the reductions appeared to stem chiefly from factors other than the metal strikes. Transportation equipment declined largely because of a sharper-than-usual drop in automobile output in preparation for model changes, while machinery output was affected by a cut in television set production—which often shows erratic month-to-month movements. Output of nondurables, on the other hand, held steady at the record level attained in July.

Appreciable effects on employment also began to show up in August. Approximately half a million workers were on strike in mid-August, while about 125,000 others had been laid off in steel-using and steel-servicing industries; in addition, unrelated to the strikes, there were larger-than-usual layoffs at automobile plants. These losses were only partially offset by gains in trade, construction, and government employment, so that total nonfarm employment fell by 540,000 from the record mid-July level (seasonally adjusted Bureau of Labor Statistics series). Unemployment in mid-August was estimated by the Census Bureau at 3.4 million persons, a less-than-usual decrease from July's 3.7 million, so that seasonally adjusted unemployment rose from 5.1 to 5.5 per cent of the civilian labor force. (This did not include strikers, except in the relatively few cases where other work was actively sought.) It is estimated that by the middle of September approximately 35,000 more workers were idled because of the steel strike.

Chart II
PLANT AND EQUIPMENT OUTLAYS
Seasonally adjusted, annual rates



Sources: United States Department of Commerce, and Securities and Exchange Commission.

UNDERLYING STRENGTH IN DEMAND

Despite the slowdown in certain major lines of activity, indications are that underlying business and consumer demands have remained strong and that production and employment will rebound rapidly once the strikes are settled. The latest United States Commerce Department-Securities and Exchange Commission survey of plant and equipment spending intentions is especially impressive in this regard. Taken in July and August, the survey pointed to a firm upward trend in outlays through 1959 and revealed significant upward revisions from plans reported earlier this year in nonmanufacturing lines. Total plant and equipment outlays were estimated to be at a seasonally adjusted annual rate of $34.3 billion in the quarter just ended, while a rate of $35.3 billion was anticipated for the final three months of this year, compared with $30.6 billion and $32.5 billion in the first two quarters of 1959. As indicated in Chart II, the anticipated spending rate for the fourth quarter represents a recovery of about two thirds of the decline from the peak in 1957 to the recession low point in 1958. For all of 1959, the latest survey indicated spending plans of $33.3 billion, up 9 per cent over 1958 and 5 per cent more than was anticipated on the basis of a similar survey early this year.

Business demand for inventories has been strong, too, and of course will receive a further impetus once the steel strike is ended. In July, total business inventories increased by $500 million (seasonally adjusted) despite the effects of the steel strike, as retail and wholesale establishments continued to build stocks. Manufacturers added to inventories at an average monthly rate of $500 million in the first half of 1959 (seasonally adjusted), reflecting the accumulation of steel stocks in anticipation of a strike, but their inventories rose by only $100 million in July and declined by $200 million in August as steel supplies were worked lower. By the end of July the inventory/sales ratio for all businesses had edged up slightly from the eight-year low reached last spring, but remained substantially below the level of recent years.

Consumer demand has also been holding up well, although temporarily dampened to some extent by income losses stemming from the steel strike. In August the seasonally adjusted annual rate of personal income dipped by $2.6 billion to $381.4 billion: a $3.0 billion cut in the annual rate of pay in manufacturing and a $0.7 billion decline in farm proprietors' income were only partially offset by gains in other types of income. Partly as a result of lower personal income and partly because of the unusually hot weather in eastern States, retail store sales slipped to a seasonally adjusted annual rate of about $218 billion in August from a record $220 billion in July, according to advance reports. The scattered available sales data for early September are inconclusive; new car sales declined more than seasonally from the August rate, while department store sales showed seasonal gains, assisted by the onset of cooler weather in some areas.

Home building continued strong in August, although the seasonally adjusted annual rate of starts, at 1,340,000, was not quite so high as in earlier months this year. The slight downward trend in the past few months partly reflects the strong competitive pull of credit demands from other sectors of the economy, which has limited the supply of mortgage funds.

Average wholesale prices have shown little change during the strike period. Farm and food products prices declined in July and August but recovered slightly in the early weeks of September, while industrial prices held virtually unchanged on the average, at a level about 2 per cent higher than a year earlier. Consumer prices were down by $\frac{1}{10}$ of 1 per cent in August to 124.8 per cent of the 1947-49 average, following four months of consecutive increase. This small reduction was attributable to seasonal declines in food prices. In spite of the decline, the consumer price index in August was still at the highest point on record for that month, and prices of most nonfood goods and services continued to rise.

Money Market in the Third Quarter

Money market pressures became more intense over the summer months, as bank loans continued to expand at the near-record rate that had emerged in the second quarter. Major banks raised the rate of interest on loans to prime borrowers to 5 per cent on September 1 from the 4½ per cent level that had been established only last May 18, and other short-term money rates also adjusted rapidly upward in late August and early September. Subsequently, the twelve Federal Reserve Banks raised their discount rates to 4 per cent (from 3½ per cent) in the period from September 11 to 18. Net borrowed reserves of member banks generally held in a rather narrow range around $500 million during the three months July through September; borrowings from the Reserve Banks frequently rose above $1 billion.

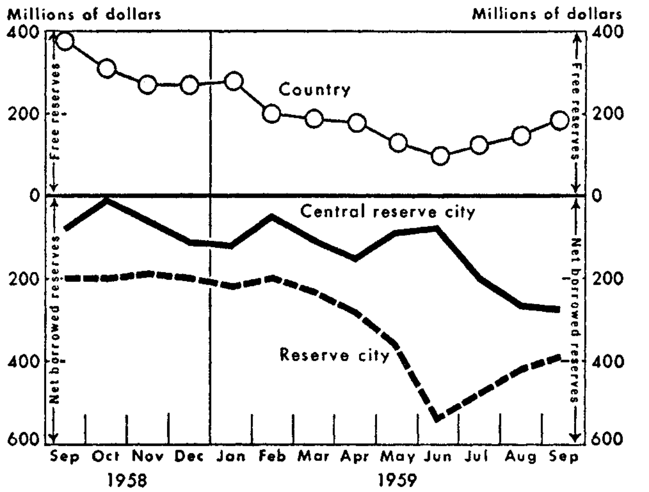
Yields on short-term Government securities have fluctuated sharply during the past three months. Market rates rose rapidly in the first half of July, as the Treasury borrowed $5 billion through two issues of longer term Treasury bills, and then declined sharply in the last half of July as strong nonbank investment demand appeared for the new bills and for two high-coupon note issues the Treasury offered in refunding an August 1 certificate maturity. The pressures on the Government securities market then became quite severe during the period of interest rate adjustment in August and September. Yields on most issues moved into new ground, reaching successively higher postwar peaks during the first half of September. Market yields subsequently stabilized and tended to move slightly lower at all maturity levels in the last half of September. In part, the decline in prices (or rise in yields) over the summer months stemmed from a widely held belief that the economy would enter a period of high level economic activity and strong credit demands after the steel strike had been settled, and that these credit demands, including additional seasonal borrowing by the Treasury, would create even more severe pressures in the credit markets. An important influence on short-term interest rates also was a combination of seasonal and special factors—including a drain of funds from New York, the September corporate tax and dividend dates, and cash needs of auto and steel companies that are major investors in short-term obligations—which at times placed the central money market under particularly acute pressure.

MEMBER BANK RESERVES

While net borrowed reserves of member banks tended to remain near the $500 million range that prevailed in June, there were pronounced shifts in the distribution of reserves during the third quarter. Reversing the trends in the second quarter, reserve positions of the reserve city and country member banks improved (see Chart I), while the New York central reserve city banks found it increasingly necessary to rely upon borrowed funds to replace reserves lost to other centers. In addition to making steadily large purchases of Federal funds, the New York City banks stepped up borrowings from the Reserve Bank.

Purchases of Government securities for the System Account provided the banking system with $0.5 billion of reserves over the third quarter, offsetting a reserve absorp-

Chart I
RESERVE POSITIONS OF MEMBER BANKS
Monthly averages of daily figures



tion of a roughly similar amount resulting from other factors. Among the major sources of reserve drain was a \$0.2 billion net purchase of gold by foreign accounts. This outflow was about one half that of either the preceding quarter or the third quarter of 1958. (Although the gold stock actually declined by \$0.7 billion, net, over the second quarter of 1959, \$344 million of this decline represented the quota payment made by the United States to the International Monetary Fund; \$300 million of this transaction had no effect upon member bank reserves since payment was made by drawing down the Treasury's "free gold".) Additional claims on reserves were made by a \$0.1 billion build-up in Treasury balances at Reserve Banks and a \$0.1 billion rise in required reserves. Required reserves rose sharply in July in reflection of commercial bank subscriptions to the securities offered in the Treasury's cash financing, but dropped back through mid-August. In September, heavy business borrowing, partly to meet September income tax payments, caused required reserves to climb once again.

COMMERCIAL BANK CREDIT

Commercial bank loans grew by a record \$7.0 billion over the first eight months of 1959, in a strong advance that commenced late in the first quarter of the year (see Chart II). Data for all commercial banks indicate that total loans increased \$5.1 billion in the second quarter, compared with an increase of \$3.6 billion in 1955 when the economy was in approximately the same phase of expansion. For the first two months of the third quarter, loans by all commercial banks increased by another \$2.3 billion, compared with an increase of only \$1.4 billion for July and August of 1955. However, data for weekly reporting banks, covering most of September, indicate some slowdown in the pace of growth, reflecting a decline in securities loans and a somewhat less rapid expansion of business loans.

For the third quarter through September 23, total loans of the weekly reporting banks rose by \$1.5 billion (see Table II), about four fifths of the 1955 expansion and sharply contrasting with the \$1.1 billion reduction last year. Consumer and real estate loans, which played an important role in the near-record loan expansion earlier this year, were apparently a major factor in the third-quarter loan increase as well. "All other" (largely consumer) loans of the weekly reporting member banks increased by \$580 million during the twelve weeks of the third quarter for which data are available, and loans to financial intermediaries that do a considerable amount of lending to consumers grew by \$181 million. In addition, real estate loans made by the reporting banks increased by \$264 million. The \$1.0 billion combined increase in these loans accounted for nearly 70 per cent of total loan growth at

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

Factor	Daily averages—week ended					Net changes
	Sept. 2	Sept. 9	Sept. 16	Sept. 23	Sept. 30	
Operating transactions						
Treasury operations*	− 13	+ 132	+ 15	− 202	− 40	− 108
Federal Reserve float	− 114	− 17	+ 198	+ 482	− 401	+ 148
Currency in circulation	+ 19	− 175	− 90	+ 213	+ 175	+ 142
Gold and foreign account	− 78	− 17	− 57	+ 24	− 32	− 160
Other deposits, etc.	+ 22	− 7	− 33	− 51	+ 85	+ 16
Total	− 164	− 84	+ 33	+ 466	− 213	+ 38
Direct Federal Reserve credit transactions						
Government securities:						
Direct market purchases or sales	+ 132	+ 13	− 20	− 6	− 74	+ 45
Held under repurchase agreements	− 14	+ 50	+ 3	− 94	—	− 55
Loans, discounts, and advances:						
Member bank borrowings	+ 25	+ 92	+ 2	− 200	− 138	− 219
Other	− 1	+ 1	—	—	—	—
Bankers' acceptances:						
Bought outright	—	+ 1	− 2	+ 1	− 1	− 1
Under repurchase agreements	+ 1	+ 1	− 2	—	—	—
Total	+ 144	+ 158	− 20	− 300	− 212	− 230
Total reserves	− 20	+ 74	+ 13	+ 166	− 425	− 192
Effect of change in required reserves†	− 15	+ 68	− 91	− 96	+ 122	− 12
Excess reserves†	− 35	+ 142	− 78	+ 70	− 303	− 204
Daily average level of member bank:						
Borrowings from Reserve Banks	965	1,057	1,059	859	721	932‡
Excess reserves†	432	574	496	566	263	466‡
Net borrowed reserves†	533	483	563	293	458	466‡

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† These figures are estimated.
‡ Average for five weeks ended September 30, 1959.

the weekly reporting banks between July 1 and September 23.

Business loans, exclusive of loans to sales finance companies and other financial intermediaries, increased by $892 million at the weekly reporting banks during the third quarter. This expansion was several times greater than in comparable periods of the preceding two years, but somewhat less than the increases of 1955 and 1956. All major industry groups, except producers of metals and metal products, raised their bank indebtedness in 1959, but the largest part of the total business loan increase reflected borrowing by food, liquor, and tobacco processors, textile firms, commodity dealers, and public utilities. Despite the work stoppage in the steel industry which began in mid-July, the reduction in borrowings of metals firms was only about $100 million, less than one third of the net repayment made by these firms in each of the three preceding years; in the same weeks of 1955, these loans had risen slightly. The repayments by metals firms was concentrated in the closing weeks of the quarter. In addition, several other industry groupings borrowed less in this period than in other years.

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

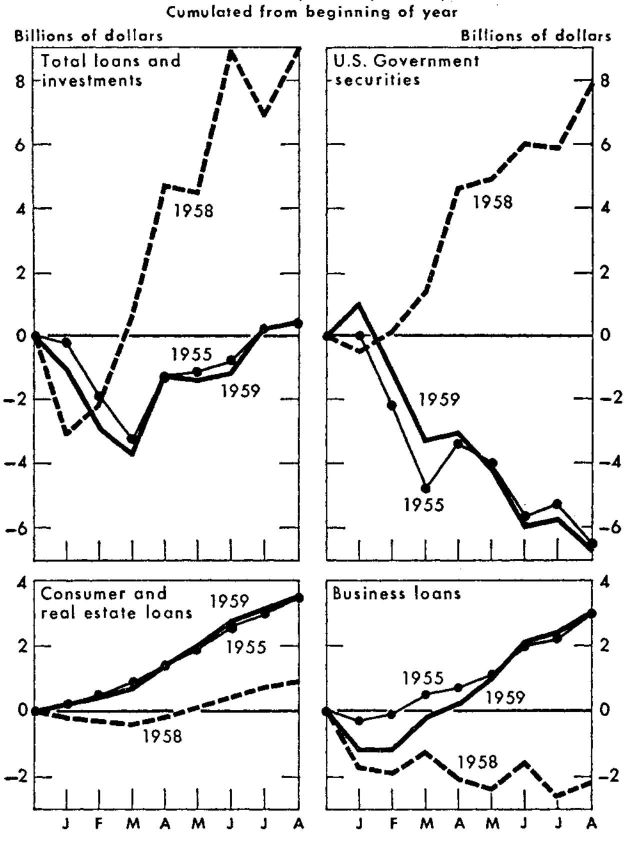
Assets	1959		Third quarter*		
	I	II	1955	1958	1959
Loans and investments:					
Loans:					
Commercial and industrial loans....	− 208	+1,425	+1,334 }	− 93	+ 963
Agricultural loans.................	− 38	+ 47		+ 50	+ 46
Securities loans...................	− 111	− 148	− 276	−1,331	− 331
Real estate loans..................	+ 233	+ 413	+ 364	+ 276	+ 264
All other loans (largely consumer)...	+ 226	+ 939	+ 517	+ 33	+ 580
Total loans adjusted†...........	+ 90	+2,657	+1,931	−1,067	+1,502
Investments:					
U. S. Government securities:					
Treasury bills..................	+ 272	− 900	+ 80	− 991	+ 295
Other..........................	−1,623	−2,317	−1,530	− 119	−1,917
Total........................	−1,351	−3,217	−1,450	−1,110	−1,622
Other securities...................	+ 209	− 257	− 83	+ 319	− 17
Total investments..............	−1,142	−3,474	−1,533	− 791	−1,639
Total loans, adjusted,† and investments..	−1,052	− 817	+ 398	−1,858	− 137

* Because of a change in reporting methods, 1959 data are not strictly comparable with earlier years. The latest 1959 data available are for September 23; third-quarter changes for each year cover approximately the same period.

† 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.

Chart II

CHANGES IN LOANS AND INVESTMENTS AT ALL COMMERCIAL BANKS, 1955, 1958, AND 1959
Cumulated from beginning of year



Note: Data for 1959 are partly estimated and exclude structural changes resulting from the addition of banks in Alaska and Hawaii.

The banks met the heavy demands for loans during the summer, as they had earlier in the year, by liquidating investments. Government securities holdings of the weekly reporting banks declined by $1.6 billion over the third quarter, or by more than the loan expansion for this group of banks. The third-quarter liquidation of Governments was particularly impressive in view of the fact that Treasury debt operations added about $5.0 billion to the supply of marketable securities during this period. Indeed this pattern also holds for the past year and more; from the end of June 1958 through August 1959, Government securities holdings of all commercial banks declined by $4.5 billion while the total marketable Government debt jumped by nearly $18 billion.

The seasonally adjusted money supply—demand deposits adjusted and currency outside banks—is estimated to have increased at an annual rate of 1.7 per cent over the first eight months of 1959, compared with 4.6 per cent in the similar interval of 1958 and 3.6 per cent during this period in 1955. The relatively moderate rate of growth of the privately held money supply thus far in 1959 as compared with 1955, in spite of an approximately parallel movement in bank assets, is attributable to a sizable increase in Government deposits at commercial banks this year, along with a continued growth in time and savings deposits. Government deposits rose by $1.6 billion in 1959 through the end of August, with $1.3 billion of the increase occurring in July and August when the Treasury raised new money through the issuance of short-term securities. Time and savings deposits at commercial banks grew by $1.7 billion during these eight months. While this rate of increase is smaller than in the past three years, it is substantially larger than the growth in 1955.

GOVERNMENT SECURITIES MARKET

The summer months of 1959 were a period of wide swings in market rates of interest, particularly in the short-term area. Clearly predominating, however, in spite of periods of market firmness, was a strong movement toward higher rates of interest at which current supplies of securities could be sold and at which, perhaps, the large credit demands anticipated for the fall months might be met. By the end of September, with market rates of interest at or close to the highest levels in thirty years, the market appeared to have developed a considerable degree of stability as it prepared for another large Treasury borrowing and for a sizable supply of other offerings.

The third quarter is typically a deficit period in Treasury operations, even in years of budget surpluses, because of the seasonal pattern of Government tax revenues. This year, however, the Treasury's heavy borrowing period also coincided with a period when business borrowing was exceptionally large, as noted earlier, and there were widespread expectations that credit demands would grow even larger once the steel strike had been settled. Consequently, particular attention was focused on Treasury financing operations, both to raise new cash and refund maturing obligations. During the third quarter, the Treasury raised $6.4 billion of funds through various forms of bill issues and refunded a total of $13.7 billion of maturing securities. Reliance upon short-term financing created particularly strong pressures in that sector of the market. In the regular weekly bill auctions, the average issuing rate on three-month bills rose to almost 4.2 per cent in the last auction held in September (see Table III), while the average issuing rate on six-month bills climbed to just under 4.9 per cent, the highest level since these bills were first issued last December. By the end of September, however, yields on outstanding issues had receded somewhat from these peak levels.

Pressure in the short-term market permeated through other maturity areas. In the intermediate (three- to five-year) sector, market yields on some outstanding issues rose to 5⅛ per cent, partly as a result of heavy liquidation by banks of securities in this maturity sector. Yields on longer term issues also rose in sympathy with general market developments, but in characteristic fashion increased less sharply. As a consequence, the longer bills and the intermediate issues offered yields which were higher than those available on long-term bonds on a before-tax basis, and in many cases were higher even after allowance for the tax advantage of the deep discounts on the longer term bonds. Rates on short bills before tax at times reached levels close to average long-term bond yields.

Early in July, the Treasury auctioned $3 billion March 1960 tax anticipation bills at an average issuing rate of 4.075 per cent. Only one week later (July 15), an offering of $2 billion of one-year Treasury bills was auctioned at an average issuing rate of 4.728 per cent—the highest borrowing cost for the Treasury since the 1920's. Strong nonbank demand appeared at the new, attractive level of short-term rates, however, and banks which had obtained the new bills at such high rates were hesitant to sell them. In consequence, the market rate on this new bill moved down sharply, to the neighborhood of 4¼ per cent by the end of July. During this interval of relative market strength, the 4¾ per cent rate on the 12½-month and 4-year 10-month notes offered by the Treasury in the refunding of August 1 certificates proved to be very attractive. The success of this refunding operation—only $233 million of the maturing issues were turned in for cash while $9.6 billion were exchanged for the one-year note and $4.2 billion were exchanged for the five-year note—further improved the atmosphere in the market, and prices of most outstanding issues moved up. During this more buoyant period, the longer of the new 4¾ per cent notes rose to a premium as high as $101^{10}/_{32}$. The favorable mar-

Table III
Yields on United States Government Securities
June 29-September 28, 1959

Week beginning		Average issuing rate on new bills		Issues due in 3-5 years*	Issues due in 10 years or over*
		3-month	6-month		
June	29	3.164	3.703	4.40	4.12
July	6	3.266	3.964	4.42	4.13
	13	3.401	4.029	4.38	4.08
	20	3.337	3.869	4.41	4.10
	27	3.047	3.860	4.40	4.10
August	3	3.043	3.737	4.37	4.08
	10	3.150	3.690	4.31	4.06
	17	3.417	3.782	4.44	4.08
	24	3.824	4.152	4.63	4.15
	31	3.889	4.468	4.71	4.24
September	7	3.979	4.473	4.73	4.25
	14	4.166	4.796	4.86	4.30
	21	3.958	4.766	4.79	4.27
	28	4.194	4.895	4.82	4.21

* Yields are weekly averages computed from daily closing bid prices.

ket atmosphere was generally maintained through the reopening of the March 1960 tax anticipation bill on August 19, when an additional $1 billion was sold at an average issuing rate of 3.719 per cent, in contrast to the 4.075 per cent rate established in the initial auction of $3 billion of these bills a month earlier.

After mid-August, however, a weaker tone developed in the market, and at times during the following month the combination of real and expectational influences created unusually heavy pressures. The large volume of new bills that had been sold, which included the $600 million raised by increasing the amount of bills offered in the regular weekly bill auctions beginning with the auction of August 10, had caused bill rates to begin moving higher before mid-August. As this upward movement of short-term rates continued, what at first appeared to be a technical reaction to the earlier sustained price rise pushed down the prices of notes and bonds, while bank liquidation of both short- and intermediate-term Government securities continued, apparently at a somewhat accelerated pace. With the approach of the September corporate tax and dividend dates, most nonfinancial corporations were less active on the buying side; seasonal cash pressures on the auto companies and strike-induced pressures on the steel and related companies were additional influences on the short-term Government securities market. Finally, the continued strength in the economy and in credit demands, in spite of the steel strike, tended to reinforce the feeling that the economy would resume its rapid advance as soon as the strike was settled and to generate expectations of further upward rate adjustments.

Pressures on the Government securities market were still in evidence in the last half of September, but renewed buying by nonbank investors and other influences had resulted in an improvement in market atmosphere despite the imminence of a new Treasury cash financing, the terms of which were announced in early October. At the end of September, securities maturing after 1962 were generally from ¾ to 1½ points lower in price than they had been at the beginning of July, and shorter notes and bonds about ½ point lower; market yields on three-month bills were higher by some 90 basis points and on longer bills by about 120 basis points.

OTHER SECURITIES MARKETS

The corporate and tax-exempt bond markets generally followed a course parallel to that traced by the Government securities market over the third quarter. Corporate bond prices were relatively firm during most of July and the early part of August, partly reflecting the favorable tone established by the successful Treasury refunding operation. In addition, the fact that the volume of new corporate offerings was relatively small, coupled with a satisfactory pattern of reoffering yields on the new issues, attracted investors to these securities. On the other hand, while prices were also relatively firm in the tax-exempt market, the much heavier calendar of offerings tended to maintain an undertone of uncertainty for the new issues throughout the summer. In the second half of August, a note of caution was introduced into both markets by the rise in short-term interest rates, the spreading pessimism in the Government securities market, the relatively close pricing of some new offerings (which moved slowly), and by an increase in the volume of prospective new issues. This combination of influences caused rates to move higher, and several syndicates were terminated with the unsold bonds offered at substantial price concessions. Over the third quarter as a whole, it is estimated that a total of $0.9 billion of corporate and $1.5 billion tax-exempt bonds was offered. The calendar in both markets during the last quarter of 1959 is expected to be substantially larger, particularly in the corporate area.

Prices in both markets continued to decline well into September, and yields in most categories of outstanding bonds reached successive new postwar peaks. By the end of September, Moody's index of Aaa State and local bonds was at 3.64 per cent and Moody's index of Aaa corporate bonds at 4.52 per cent, compared with 3.54 per cent and 4.49 per cent respectively at the beginning of the quarter. Meanwhile, the stock market, which had reached a peak early in August, thereafter declined irregularly until the third week in September, after which stock prices stabilized and recovered part of their earlier losses. As measured by the Dow-Jones industrial average, stock market prices at the end of September were about 7 per cent below the all-time peak reached on August 3 and almost 2 per cent below the level at the opening of the quarter. Nevertheless, for the quarter as a whole, the yield differential between industrial common stocks and high-grade corporate bonds continued to widen, again reflecting primarily the rise in bond yields. During the quarter, Moody's index of yields on Aaa seasoned corporate bonds was at times more than 1¼ percentage points higher than Moody's index of yields on industrial common stocks. This yield relationship helped attract buyers for the new bond issues as investors interested in current income took advantage of the new high yields available.

A number of rate increases on short-term marketable debt instruments were announced during the quarter; some rates were raised by as much as a full percentage point. Dealers in bankers' acceptances moved their bid rates from

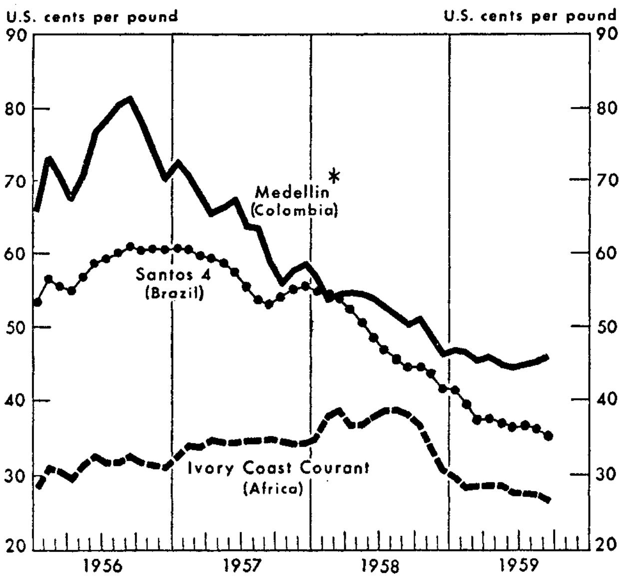
3½ per cent to 4⅜ per cent on 90-day unindorsed acceptances, with all but one of the six increases taking effect after mid-August. Similarly, beginning in late August the rate on directly placed 60-89 day paper of large sales finance companies was raised in three steps from 3½ per cent to 4½ per cent. Generally conforming to this trend, commercial paper dealers lifted their rates on prime four- to six-month maturities from 3⅞ per cent to 4¾ per cent in a series of six steps, which included one reduction announced late in July and reversed in mid-August.

International Developments

THE COFFEE STABILIZATION AGREEMENT

Last month, a majority of the coffee-producing countries signed an agreement for stabilizing the price of coffee. This commodity—one of the major products entering into international trade, with a long history of successive periods of boom and bust—has experienced a new period of falling prices since the end of 1956. Latin American coffees have been particularly hit, and by spring this year their prices had fallen by more than a third from their 1956 levels (see chart). Moreover, the volume of exports of these coffees failed to expand. As a result the Latin American countries, which account for nearly 80 per cent of world coffee production, received last year only $1.5 billion for their coffee sales in contrast to $1.9 billion in 1956. Inasmuch as coffee provides some 20 per cent of total Latin American foreign exchange earnings, and 50 to 85 per cent of the earnings of six countries (notably Brazil and Colombia), the producing countries of this area have for some time been seeking to bolster the price structure. The new agreement reflects their success in enlisting the support of other world producers as well.

SPOT COFFEE PRICES IN THE NEW YORK MARKET



Note: September 1959 partly estimated.

* In 1958-59, "MAMS" coffee, which includes both Medellin and other similar Colombian coffees.

The recent drop in coffee prices does not stem from any fall-off in demand, but from overproduction, for which no early end appears in sight. The long upward trend in coffee consumption has continued during the postwar period. The rise has in general been faster than before the war because of the increase in population, the expansion of personal incomes, and the broadening of coffee-drinking habits. Up to about 1955, this increase gave considerable support to prices, which in turn stimulated the planting of coffee trees. The traditional producers—especially Brazil—expanded their plantings on a large scale, while the newer African producers, partly influenced by the price rise, also increased their production significantly, to the point where today their exports account for 25 per cent of world coffee trade.[1] Now, as the new plantings come into production, the increase in output is far outpacing the rise in consumption. The magnitude of the surplus problem today may be gauged from the gap between the estimates of an exportable production of 57.5 million bags for the current crop year and of only 40 million bags for world import demand, not to mention a 37 million bag carry-over from previous harvests.

[1] The African countries have been favored by low production costs and by the increasing world use of soluble coffees, for which their Robusta coffee is particularly suited. The large price differential that existed toward the end of 1956 between Latin American and African coffees further strengthened Africa's position by inducing a shift in world demand in its favor.

Notwithstanding the likelihood that the coffee surplus will increase, coffee prices in recent months have tended to stabilize. This has been due primarily to the fact that consumer countries are no longer reducing inventories. In addition, the United States market, which accounts for more than half of total world coffee imports, has provided a temporary stimulus by stepping up purchases in anticipation of the dockers' strike this month. These developments have bolstered the recent joint Latin American efforts to moderate the price decline; the joint efforts have in turn been largely responsible for preventing a price collapse.

Loose gentleman's agreements to support minimum export prices had been entered into by Colombia and some Central American countries before 1957; however, these agreements did not spell out the terms of the price support, and each of the parties was left free to follow its own marketing policies. These agreements were followed by the Mexico City Agreement of October 1957, which was signed by seven major Latin American producing countries and committed each signatory to withholding from the market for one year a prescribed amount of coffee. This retention principle was again applied under a strengthened formula in the one-year Washington Agreement of October 1958, which included virtually all Latin American producers. The strength of these two international agreements lay in the joint commitment by a majority of producers to withhold excess production from the market (previously the burden of such withholdings had been borne by only one or two of the large producers) and in the further undertaking to reduce sales of coffee during the peak marketing months. However, these agreements failed to prevent a gradual decline in prices caused both by the mounting surplus and by weaknesses in the agreements themselves.

In the new international coffee agreement, participation is no longer confined to Latin American producers, but includes the African producing countries that are politically associated with France and Portugal. Together, the participants now account for 89 per cent of estimated exportable production, as opposed to only 78 per cent coverage in the previous agreement. In addition, Great Britain and Belgium, although assuming no formal commitments, have indicated that the African countries associated with them will cooperate in limiting exports. The new coffee agreement also strengthens further the retention scheme that has been the basis of all coffee agreements. Precise limits are set upon exports by assigning specific export quotas to the participants, the sum total of which is equal to the estimated coffee demand in the next twelve months. In most cases, each country's quota is equal to 90 per cent of its exports during the best of the past ten years. Such quotas eliminate the difficulties that arose when retentions were computed on the basis of estimated exportable production, which was often difficult to determine accurately.

Of course, retention schemes, however they are applied, tend to give rise to new problems, while failing to provide any basic solution to excessive output. In the first place, the withholding of crops involves government payments to producers, which often become a significant part of total budget costs and can lead to inflationary financing or to cutbacks in other important government outlays. Moreover, the price stabilization resulting from retentions is likely to encourage inefficient production at home or stimulate nonparticipating low-cost producers to increase their output and marketings at no cost to themselves. Finally, any retention scheme raises the question of enforcement, which becomes a real problem if and when the participants become tired of holding a price "umbrella" over the nonparticipants.

A more basic solution to the problem of excess production will have to be developed if the surpluses are not to cause the retention schemes eventually to break down. One solution may lie in efforts to expand world coffee consumption; producers are already intensifying their sales campaign, and further efforts and studies to expand demand have been urged. Apparently there is room for an increase in consumption over and beyond normal growth if the tendency to prepare "weak" coffee is modified, if European tariffs and consumption taxes on coffee are reduced, and if new markets are developed. However, even allowing for the most favorable assumptions regarding future consumption, it seems unlikely that a solution to the surplus problem will be forthcoming from this source.

A beginning has also been made in cutting production, but the problem is still largely unresolved. The burden of any cutbacks may well fall mostly on Latin American producers, many of which are at a competitive cost disadvantage vis-à-vis the African nations. However, a recent study[2] points out that considerable room exists for the reduction of Latin American costs; to the extent that this can be achieved, the burden of production cuts might be distributed more evenly among the producing nations. In any event, such cutbacks are likely to require the producing countries both to make large compensating payments to their producers and to step up their major agricultural-diversification programs. The reaching of an agreement

[2] Onno Van Teutem, "Coffee in Latin America: The Producers' Problem", *Economic Bulletin for Latin America,* United Nations Economic Commission for Latin America, March 1959, pp. 32-43.

on production cutbacks appears to be the next major problem to be solved if the current retention program is to prove worthwhile.

EXCHANGE RATES

While the Canadian dollar generally showed strength in the New York foreign exchange market during September, sterling fluctuated rather irregularly. Spot sterling declined 45 points early in the month to $2.8009, the lowest since September 1958. However, with Continental and commercial demand for sterling more than offsetting intermittent commercial offerings of sterling in New York and demand in London for dollars for investment in the United States, the rate then recovered and reached $2.8082 by September 23. Subsequently, it again declined, principally on Continental offerings of sterling, registering a slight net loss for September. At the month end it was quoted at $2.8043. The premiums on three and six months' deliveries, which went to 50 and 74 points at the midmonth, the widest since September 1951, narrowed to 39 and 67 at the month end.

The strength of the Canadian dollar primarily reflected commercial demand, the announcement of a $550 million offering of Canadian Government bonds, and forthcoming Canadian provincial and municipal financing in the New York market. As a result, the quotation advanced further toward the August 1957 all-time high of $\$1.06^{11}/_{64}$, rising from $\$1.04^{21}/_{32}$ on September 2 to $\$1.05^{21}/_{32}$ on September 30.

New Publications

Three new booklets are being published by the Federal Reserve Bank of New York.

The Money Side of "The Street" by Carl H. Madden, Manager of the Public Information Department, gives an account of the workings of the New York money market, and explains the functions and usefulness of the short-term wholesale money market as well as its role in the operations of the Federal Reserve System. This booklet, written for laymen and students, is now available to the general public at 70 cents a copy and at a special rate of 35 cents per copy to educational institutions on quantity orders.

Another booklet, on *Monetary Policy Under the International Gold Standard, 1880-1914,* was written by Arthur I. Bloomfield, who was associated with this Bank from 1941 to 1958 and who is now Professor of Economics and Finance at the University of Pennsylvania. This publication analyzes, in the light of current monetary and banking theory, the performance and policies of central banks within the framework of the pre-1914 gold standard. It will be available in late October at 50 cents per copy and at a special rate of 25 cents a copy to educational institutions on quantity orders.

A third, entitled *Deposit Velocity and Its Significance* by George Garvy, Adviser, Federal Reserve Bank of New York, discusses the behavior of deposit velocity, over the business cycle and over longer periods, with emphasis on the institutional and structural forces determining its behavior. This booklet will be available in early November at 60 cents a copy and at a special rate of 30 cents per copy to educational institutions on quantity orders.

The New York Foreign Exchange Market, written by Alan R. Holmes, Manager of the Securities Department, was published earlier this year by the Bank, and copies are still available at 50 cents a copy and at a special rate of 25 cents a copy to educational institutions on quantity orders.

These booklets may be obtained from the Publications Division of the Federal Reserve Bank of New York, New York 45, N. Y., at the prices indicated, plus New York City sales tax, where applicable.

Statement by the Hon. Robert B. Anderson

Secretary of the Treasury and Governor of the International Monetary Fund for the United States, at the Discussion of the Fund's Annual Report September 29, 1959

It was to be expected that the Annual Report of the Fund would point to evidences that the past year was one of great advance in several important phases of the economy of the Free World. The first evidence is the sharp upswing of industrial production in the United States and renewed expansion in other industrial countries. Second, is the continued very substantial growth in gold and foreign exchange reserves of those other industrial countries. Third, is the move to external convertibility, which signaled the end of the postwar period of inconvertibility and its accompanying comprehensive exchange restrictions.

However, the Fund Report also calls attention to the less satisfactory experience of many of the less developed countries. I agree fully with the Report that the difficult problems with which these countries have had to deal make it all the more to their credit that so many of them have taken steps to introduce or maintain comprehensive stabilization programs. All of our countries, whether industrialized or underdeveloped, face common problems arising out of the pressure of demand on economic resources, and all of us, as financial officials, are engaged in an unending struggle to contain the destructive forces of inflation.

We are glad to note that the Fund has continued to play an important role. The fact that the Fund has been ready and able to assist in the maintenance of convertibility undoubtedly was an important encouragement to the countries which made formal moves during the year. At the same time the Fund has continued to give technical advice and financial support to countries which have been planning or intensifying their stabilization efforts. Use of the Fund's resources by these countries was substantial. For many of them, however, stand-by arrangements with the Fund were as important or even more important than the actual use of Fund resources.

There is sometimes a tendency to refer to the stabilization programs with which the Fund is associated as if they were something which the Fund devised and sought to impose on one or another member country. I am sure that this view is not held by my fellow Governors. The desire to achieve and maintain stability in the economy and a sound currency as the reliable basis for economic development must arise within the country itself. If it does not, and if in consequence this objective does not have the support of all major sectors of public opinion—responsible business and labor leaders, consumers, and public officials—the efforts of the Fund to extend either technical advice or financial support are unlikely to be successful. I have noted with interest the discussion of this subject which appears at the end of Chapter II of the Report. For us in the United States Government it is encouraging to observe the effective collaboration between the Fund and a number of the member countries, and I am confident that over the years this alliance between Fund and members in the effort to provide a sound financial basis for economic expansion will be one of the most important activities of the Fund.

A year ago at the meeting in New Delhi I had the pleasure of introducing a resolution looking to an increase in the resources of the Bank and the Fund, and the great satisfaction of finding that the resolution met with the unanimous support of the Boards of Governors. Now, a year later, we can note with real pride that the Executive Boards have presented their reports, the Governors have virtually unanimously approved the proposed resolutions, and the required percentages of actual participation in the increase in resources have been exceeded. This has been an outstandingly successful international cooperative effort to increase the pool of resources available to the Fund and to increase the capacity of the International Bank to make loans.

This year the United States is proposing consideration of the establishment of the International Development Association as a desirable additional means of providing capital for the economic development of the Free World.

In his address the Managing Director of the Fund has commented on two aspects of Fund policy which are of very real interest to us in the United States Government. One of these, which is also mentioned in the Annual Report, relates to discrimination in trade and payments.

During the first decade after the war, currency inconvertibility was very widespread and, for most of that period, was severe. Under those circumstances it was to be expected that countries would husband their earnings and reserves in convertible currencies. This resulted, of course, in massive discrimination against the countries having convertible currencies—discrimination which extended to imports of goods and to various so-called invisible transactions, such as tourist travel and remittances. Although these discriminatory arrangements affected the trade of the United States, we concurred in the Fund's policy of sympathetic toleration of them pending the time when inconvertibility would give way to convertibility at least among the major currencies.

This time has come and it has been accompanied by, and in considerable part made possible by, a very substantial improvement in the balance-of-payments positions of the other industrial countries and by large increases in their reserves. In our view, the countries which no longer suffer from inconvertibility in their current international receipts do not have any balance-of-payments justification for discriminatory restrictions—that is, there is no reason for these countries to favor imports from nondollar countries over those from dollar countries. We have been very much gratified by the substantial progress which countries have made in reducing and eliminating discriminatory restrictions. But it has to be said that discrimination against the trade of dollar countries is still substantial, and that it applies to commodity trade and some other transactions, especially the freedom of tourists to obtain funds to travel wherever they wish. We consider that it is most important for the Fund to declare its position on this matter clearly and forcefully. This would be shown not only by the actions of individual countries but by the Fund itself in the weeks following this Annual Meeting. This is of particular concern to the collaboration between the Fund and the GATT.

The Managing Director has mentioned that many countries have reached the point where they soon will no longer need to avail themselves of the transitional privileges of Article XIV, which deals with restriction on payments and transfers in international transactions, and will accept the obligations of Article VIII. We agree with this view, and we also agree with him that it is time for the Executive Board of the Fund to examine the several important questions of policy connected with Article VIII which will need clarification as a guide to the many member countries still operating under Article XIV.

I should like now briefly to review some of the economic and financial developments in the United States during the year. The Annual Report gives considerable attention to the United States and I appreciate the objective way in which the developments in my country have been analyzed. We in the United States Government keep always in the forefront of our minds that our economy is a very large one and that what happens here, whether good or bad, is of concern for other countries of the Free World. At the same time, however, I agree with the line of analysis in the Annual Report pointing to the steady strengthening of the European economies in recent years and to the substantial and autonomous economic power and influence of the Western European economy in world affairs.

The main purpose of the United States in the financial and economic field is to maintain a strong and expanding economy on both the domestic and international fronts. Only economic strength can support a steadily rising standard of living for the people of the United States and only through economic strength can the United States play its proper role in the defense of the Free World and in assisting the underdeveloped countries of the world, to whom economic advance is so vital.

To maintain and enlarge the economic strength of the United States we rely on a few main lines of policy. These include, first, a sound fiscal position which will both avoid inflation and meet the very large expenditures at home and abroad which the United States Government must undertake. Second, firm and yet flexible monetary policies aimed at achieving and maintaining stable purchasing power for the dollar and an adequate basis for large and growing savings. Third, maintenance of competitive private enterprise and high employment opportunities within the framework of sound social and economic policies. Fourth, improvement of our technology and production efficiency so that we can expand our markets at home and abroad.

Turning to the balance-of-payments position of the United States, the present situation is this. The excess of exports of United States goods and services over our imports is currently running at the rate of about $3 billion per year. This excess is not sufficient to meet three large categories of outpayments by the United States which in the aggregate amount to about $7½ billion a year. There is a difference of roughly $4½ billion. Some of these outpayments are directly associated with and add to our exports; others bear a much more indirect relationship to our trade. But their over-all effect is to provide foreign countries with substantial net receipts of dollars.

One of these three large outpayments by the United States consists of military expenditures abroad, which have been running over $3 billion in recent years. The second is net United States Government grants, loans, and other capital outflow of about $2½ billion a year. The third is the outflow of private capital which amounts to $2 billion or more per year. Despite heavy demands on our savings at home, reflected by rising interest rates, we are making substantial amounts of these savings available to underdeveloped countries. Moreover, large contributions to the defense of the Free World are an important part of the international policy of the United States Government and of all of the Free World.

The resulting large payments deficit or difference of about $4½ billion is accounted for mainly by foreign gains of gold, dollar holdings, and both short- and long-term foreign investments in the United States. It is our hope that this large payments difference will be reduced by increases in our commercial exports of goods and services relative to our imports of them. But, while we will put emphasis on strengthening our capacity to export, we cannot be unmindful of other factors and therefore we will also keep our whole international financial position under review.

The United States dollar is a reserve currency. In our modern monetary and exchange systems, the role of a reserve currency is essential, and it is natural that foreign central banks and treasuries as well as private persons and institutions abroad should hold dollars in substantial amounts. This means that while it is, of course, in our own interest to keep the strength of the dollar beyond question, we must also be aware of the interest of other countries which rely on the dollar as a reserve currency.

It is, however, important also to look at the world payments situation as a whole and not at the position of the United States alone. In 1958 the other industrial countries of the Free World had a substantial payments surplus not only with the United States but also with the less developed members of our institutions. These surpluses substantially exceeded the long-term financing made available by these countries to the rest of the world. That is to say, their net exports were substantially greater than the financing which they provided to cover them, resulting in an unusually large addition to liquid holdings of foreign exchange, on both official and private account. A similar situation has continued in 1959. This large excess of exports over the outflow of capital does not represent a satisfactory pattern of world payments, and cannot be expected to persist.

The passage of time changes circumstances, and these changes continually force upon us all the need to review our policies. Following World War II, when many countries were suffering from the ravages of war and when their foreign exchange reserves were very low, the principal policies of the United States in the foreign financial and economic fields were designed to assist in rebuilding economies and to strengthen currencies. But now there has been a restoration of the relative competitive positions of the other industrial countries of the Free World. No longer is the United States the dominant supplier of capital goods and other manufactures. The other industrial countries have improved their own financial positions. This means that there is no longer a justification for the discriminatory practices of the earlier period of their economic and financial weakness. Finally, the changed circumstances of the industrial countries ought to put at rest any unfounded idea that the economic problems of the Free World are based either on a shortage of dollars or on a general lack of liquidity.

What we must recognize is that we are confronted today *not* with a dollar shortage, but with a capital shortage. The demand for capital is high in all countries, both industrial and underdeveloped. But on a comparative basis, there is in the underdeveloped countries a strong and pressing demand for long-term funds from countries with high savings to supplement their own savings so as to accelerate the pace of economic development. This demand for capital need not be satisfied by any one currency, but by all convertible and usable currencies. We in the United States will not shirk any part of our responsibility to help in this situation. But I believe that examination of the recent past shows that financing by the United States has exceeded the amount of its net exports of goods and services and that other industrial countries have generally financed less than their exports of goods and services. There must be a reorientation of the policies of the earlier postwar period and a new determination by all the industrial countries to face the common obligation to share in the task of providing capital to the less developed parts of the Free World.

Turning now to the domestic side, I am very glad to be able to report, as does the Annual Report itself, that the year since we met in New Delhi has been one of continued economic upsurge in the United States. By June, just prior to the steel strike, industrial production had reached 6 per cent above the pre-recession peak. Gross national product is currently running about $485 billion per annum, compared with $442 billion in the year before the recession. Moreover, this dramatic and rapid increase in economic activity has been achieved with substantial price stability. Since the beginning of recovery in May 1958, the broad index of wholesale prices has shown no net increase, while consumer prices have risen only 1 per cent.

The fiscal position of the United States, which is a major factor in our attempts to stabilize prices, has shown a notable improvement. Following the large deficit of

\$12½ billion in the fiscal year ended June 30, 1959, the United States Government has made great efforts to restore a balanced budget in the current fiscal year. My report to you on the state of affairs in the United States would be less optimistic were I not able to state that this objective appears to have been substantially attained. In this achievement we have faced the difficulties common to many countries in the world today, who must postpone or curtail some government expenditures in order that financial stability may be maintained.

The credit and monetary policies of the United States, including our firm policy of maintaining unchanged the present official price of gold, have also been directed toward promoting financial stability in the interest of sustainable economic growth. The present business boom, which has carried production, employment, and incomes to record high levels, has resulted in a rising tide of demand for bank credit from many sources. This has been reflected, of course, in sharp increases in market rates of interest and in appropriate increases in rediscount rates. Yet a large volume of new bank funds has been made available to finance the growing needs of business, as indicated by an increase of \$9½ billion in loans and investments of all banks during the twelve months through August and an increase in the money supply during that period of \$4 billion.

In summary, I can say that the outlook for the economy of the United States is good. We have contained the inflationary pressures which were running strong a year ago. Our budget position is sound. The purchasing power of the dollar has held virtually unchanged over the past year. Output and employment and incomes are at record high levels. Expanding world markets provide us an opportunity to increase our exports.

In all these vital matters of fiscal affairs, currency stability, expanding output, and a sound balance of payments, we in the United States Government support the same sound position as do the Governments represented around this table. Firm policies and vigilant and energetic execution of those policies are essential. The task of achieving sustainable growth and reasonable currency stability is never completed.