FEDERAL RESERVE BANK OF NEW YORK

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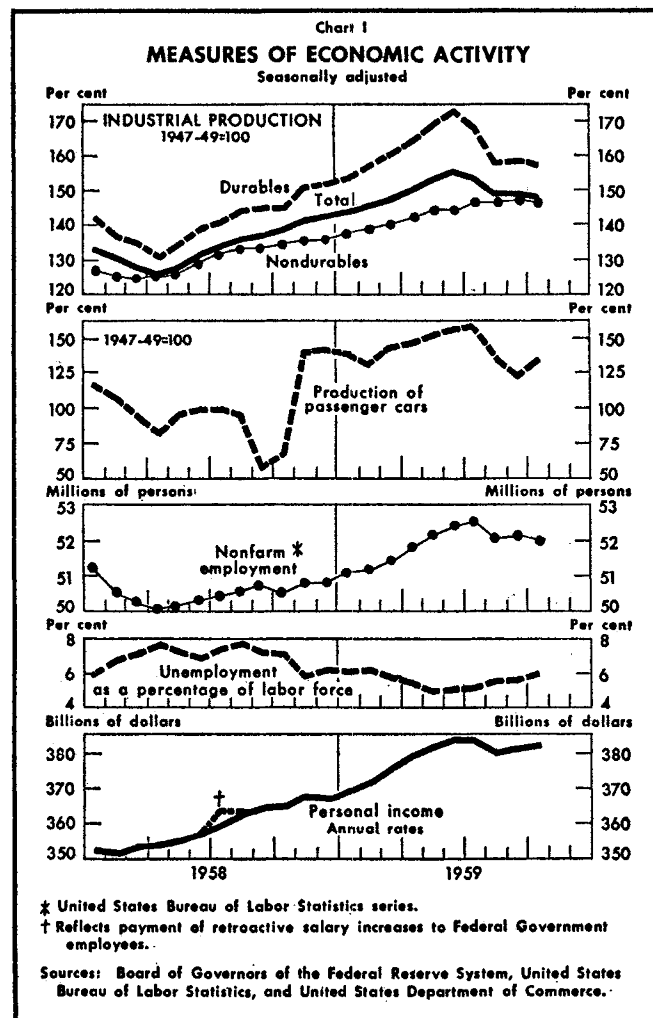
The Business Situation

Steel output rebounded sharply beginning in the second week of November, as striking workers returned to the mills as a result of a Federal court injunction. By the end of the month, output of ingot steel had risen to an estimated 90 per cent of capacity—as against an average of 12 per cent from mid-July to early November—and a start had been made in recalling workers in various steel-using lines. Most observers seem to expect that the economy's pre-strike records in output, income, and employment will be regained and surpassed rapidly, assuming of course that the strike is not renewed after the injunction expires on January 26 and that transportation is not disrupted by a breakdown of labor negotiations in the railroad industry.

At least a part of the confidence in a quick return to high level activity is due to evidence newly available during the past month on such broad measures as total industrial output, personal income, and retail sales, all of which have held up well despite the steel and other metals strikes. Cautious optimism is also suggested by a new survey of businessmen's plans for capital expenditures in 1960, which points to a sizable increase over 1959 outlays—only partly reflecting the deferral of expenditures because of steel shortages.



Industrial production declined slightly in October, seasonally adjusted, after having remained steady in September according to revised figures. (Earlier estimates had indicated that output was down one point during September.) The estimated decrease of one point in October to 148 per cent of the 1947-49 base was spread among many types of goods, embracing both durables and nondurables (see Chart I). At least in part, these declines reflected the direct effects of the metals strikes—for example, the further dip in the already low level of primary metals output and the decline in fabricated metals products. A major exception was the output of automobiles, which had dropped in September because of unusually early and extensive shutdowns for model changes, but which picked up rapidly in October as new models were introduced. By the end of October the pinch of steel shortages was being felt quite severely, and in November auto assemblies were far short of scheduled levels. Toward the close of the month, however, production of component parts began to increase again with the renewed, though still limited, availability of steel.

Output in the steel industry itself rebounded more quickly than had been expected. Damage to furnaces proved to be rather slight despite the long shutdown, and production of ingots—the first stage in the flow of processed steel—jumped to about 45 per cent of rated capacity in the first week after the injunction had taken effect, and to 90 per cent of capacity by the end of the month. Deliveries of finished steel were also made quickly in those cases where the steel had been in process when the strike began or where mills were supplied by customers with steel for final conversion. While long delays in the output and delivery of particular types of processed steel meant continued curtailments for many steel users, even a small increase in supplies helped some of those firms that had been adversely affected by unbalanced inventories.

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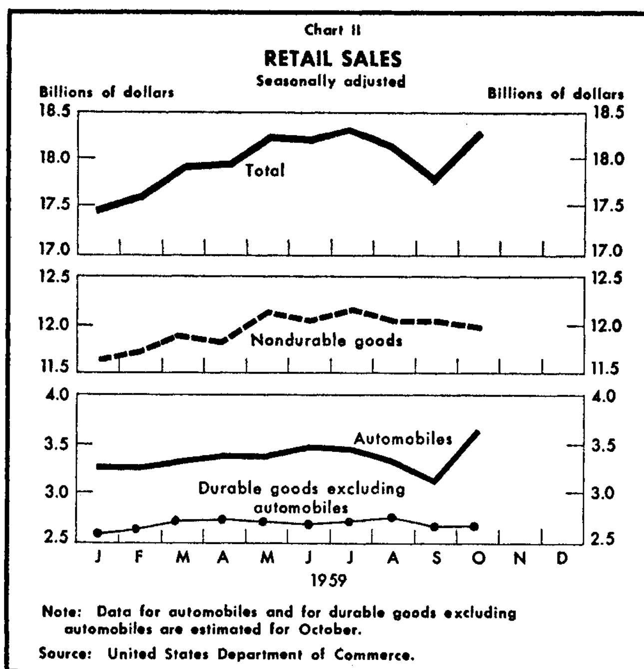
Although industrial production was in general remarkably well sustained during the metals strikes, construction activity declined in October for the fifth consecutive month on a seasonally adjusted basis. Shortages of structural steel seem to have played a direct role in the recent declines in private nonresidential construction, which first turned down in September, and in public projects such as road and bridge building. On the other hand, more than two fifths of the $1.5 billion drop in the seasonally adjusted annual rate of construction in October reflected a slower rate of private residential building—in large part stemming from the continued successful competition of other borrowers for funds that might have gone into mortgages.

The repercussions of the shutdown in steel continued to depress nonfarm employment which declined from mid-September to mid-October by about 160,000 persons to 52.0 million (seasonally adjusted Bureau of Labor Statistics series). The decline centered in manufacturing, paralleling the slight dip in industrial output, while construction employment also decreased and changes in other lines were mixed. The estimated number of persons out of work rose only slightly, but the increase—about 40,000 to a total of 3.27 million—was contrary to the usual decline from September to October; this was reflected in a rise in the seasonally adjusted unemployment rate (number of unemployed as a proportion of the civilian labor force) from 5.6 to 6.0 per cent (Chart I). Unemployment was probably higher at the end of October due to the accelerated rate of layoffs in steel-using industries. The number of people out of work because of the strike had risen to ½ million (not counting the strikers) by the beginning of November and had presumably risen further just before the injunction took effect. The return of the steelworkers to the mills, however, signaled the rapid recall of approximately 100,000 employees in industries closely related to steel—particularly railroads and coal. In other industries, recalls of laid-off workers were also proceeding, although more gradually, and a few firms were still announcing new layoffs in November because of steel shortages.

Despite the edging-down of industrial production and the rise in unemployment, personal income (after seasonal adjustment) rose in October for the second consecutive month, regaining half the ground lost between June and August (see Chart I). Half of the billion dollar increase in October, at an annual rate, came from a rise in agricultural income following declines in August and September. There were also increases in transfer payments (including social security and unemployment compensation) and personal interest receipts which more than offset a $200 million decline in wages and salaries.

The strength of personal income has helped to sustain consumer demand. Following slight declines in August and September that were traceable in large part to a weakening in automobile sales as the old model-year ended, retail sales in October rose about 3 per cent above the September rate and very nearly regained the July peak as shown in Chart II. Again, the volatile automobile component was largely responsible for the advance, as 1960 models were introduced. Toward the end of October and in early November, however, new car sales were tapering off, largely because steel shortages held down production. Industry sources have estimated that dealers would have only 445,000 new cars in stock at the end of November—down from about 960,000 earlier this year and likely to rise only slowly in the near future owing to current limitations on production.

Sales of consumer goods other than autos have decreased slightly since July, but have remained well ahead of year-ago levels. The decrease was mainly in nondurables lines, some of it apparently attributable to unusually warm weather in August and September, while the slight decreases in income as a result of the steel strike also may have played a part. In the case of durable goods other than autos, some of the recent contraction in sales may relate to the decline in home building, which may have reduced the demand for household durables. The estimated decline in sales of all consumer goods other than



Note: Data for automobiles and for durable goods excluding automobiles are estimated for October.
Source: United States Department of Commerce.

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autos was smaller in October than in preceding months.

According to a recent survey by McGraw-Hill, businessmen quite generally expect 1960 sales to show appreciable gains over 1959, and are planning to increase their outlays for new plant and equipment by 10 per cent next year. Some of this increase represents expenditures postponed from the latter part of 1959 by steel shortages but, even after allowance for this special factor, these plans point to a further rise in investment demand. While third-quarter corporate earnings apparently declined from the very high second-quarter rate in many lines, earnings for the first three quarters are still substantially above year-ago levels—thus expanding internal sources which, according to McGraw-Hill, are expected to provide the bulk of the financing for planned investment.

Recent price developments have been mixed. At the wholesale level, average prices declined slightly in October and November as the prices of farm and food products decreased sufficiently to more than offset the upward pressure from strong demand and short supplies in some industrial commodity markets. Consumer prices, however, continued to climb in October, with the index moving up three tenths of a point to 125.5 per cent of the 1947-49 average, almost two points above a year ago. Over half of the increase in October reflected higher prices paid for newly introduced 1960 automobile models. Although list prices on these cars were about unchanged, the 1959 models had been available at substantial discounts in recent months. Rises also occurred for all other major groups of goods and services except foods, which declined slightly.

Money Market in November

Tightness continued to characterize the money market during most of November. The effective rate for Federal funds held firmly at the 4 per cent ceiling on each day of the period, with demand often exceeding the supply. Moreover, the rates at major New York City banks on new and renewal loans to Government securities dealers rose early in the month to 5 per cent and remained continuously at that level. Member bank reserve positions, country-wide, continued under steady pressure during most of the month, with average net borrowed reserves of all member banks at around $420 million. New York central reserve city banks were under increased pressure and made substantial purchases of Federal funds on most days of the period and maintained their borrowings from the Federal Reserve Bank at a relatively high level.

Prices and yields in the Government securities market moved irregularly through most of the month, with a general tendency toward higher yields and lower prices. Frequent changes in short-term expectations had a particularly marked effect on the Treasury bill market. Rates on most bill issues moved higher over the month in short but pronounced spurts, and the average issuing rate for 91-day bills reached new peaks in the November 16 and November 30 auctions. The skittish behavior of bill yields during the period was traceable in part to the resumption of steel production and its possible implications with respect to the liquidation of Treasury bills by industrial concerns as well as with respect to increased credit demands. Short-run rate expectations were also affected by the Treasury's refunding operation early in the month and, in the latter part of the period, by its $2 billion cash financing and its proposed offering of 4¾ per cent notes maturing May 15, 1964 to holders of $1.6 billion of nonmarketable securities maturing in 1960. Bidding in the November 24 auction for the $2 billion new 320-day bills was cautious, and although the market rate on the bills declined for a few days, it closed the month at about the 5 per cent level.

After the close of business on November 30, the Board of Governors of the Federal Reserve System announced that a portion of the vault cash holdings of member banks would become eligible for meeting required reserves.

MEMBER BANK RESERVES

Net borrowed reserves of all member banks averaged $421 million for the four statement weeks ended in November, compared with a $471 million average in the four statement weeks ended in October. Average excess reserves declined $13 million to $432 million, while average borrowings from the Federal Reserve Banks decreased $63 million to $853 million.

Regular market factors withdrew reserves, on the average, in each week of the period except during the third week when the usual midmonth expansion in float led to a small increase in reserve availability. Over the four statement weeks, the absorption of reserves was due primarily to a seasonal increase of about $400 million in average currency in circulation, with the effects of other market factors tending to cancel out. Required reserves declined on the average by $141 million over the period

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

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

Factor	Daily averages—week ended				Net changes
	Nov. 4	Nov. 11	Nov. 18	Nov. 25	
Operating transactions					
Treasury operations*	+ 49	+ 9	− 18	− 37	+ 3
Federal Reserve float	− 252	+ 50	+ 218	+ 146	+ 162
Currency in circulation	− 47	− 185	− 130	− 34	− 396
Gold and foreign account	+ 103	− 20	+ 7	− 12	+ 78
Other deposits, etc.	− 53	—	− 42	− 100	− 195
Total	− 199	− 145	+ 34	− 37	− 347
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 180	+ 30	+ 19	+ 59	+ 288
Held under repurchase agreements	+ 121	+ 47	− 80	− 79	+ 9
Loans, discounts, and advances:					
Member bank borrowings	+ 36	+ 82	− 52	− 34	+ 32
Other	+ 1	—	—	− 1	—
Bankers' acceptances:					
Bought outright	+ 3	+ 1	—	+ 6	+ 10
Under repurchase agreements	+ 1	− 1	—	+ 3	+ 3
Total	+ 342	+ 158	− 111	− 47	+ 342
Total reserves	+ 143	+ 13	− 77	− 84	− 5
Effect of change in required reserves†	− 54	+ 104	+ 12	+ 79	+ 141
Excess reserves†	+ 89	+ 117	− 65	− 5	+ 136
Daily average level of member bank:					
Borrowings from Reserve Banks	826	908	856	822	853‡
Excess reserves†	378	495	430	425	432‡
Net borrowed reserves†	448	413	426	397	421‡

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

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for four weeks ended November 25, 1959.

System open market operations during this period roughly offset the seasonal reserve losses stemming from the expansion in currency. Outright System holdings of Government securities rose $330 million from October 28 to November 25, while holdings under repurchase agreements increased $29 million.

The Board of Governors announced on November 30 that, effective December 1, 1959, country banks would be permitted to count vault cash in excess of 4 per cent of their net demand deposits as part of their required reserves while, effective December 3, reserve city and central reserve city banks could similarly count vault cash in excess of 2 per cent of their net demand deposits. It is estimated that almost half of all member banks will be in a position to utilize part of their vault cash as required reserves, and that as much as $230 million of reserves would thereby be released. This action involved no change in the System's general monetary or credit policy. It comes at a time when it is normal System practice to supply reserves to meet the seasonal requirements of the economy. At the same time, the Board announced several technical amendments to its regulations, including one whereby effective December 31, 1959 the reserve computation period for country banks will be biweekly instead of semimonthly.

GOVERNMENT SECURITIES MARKET

In the Treasury's November refunding, $8,366 million of the $8,894 million 3⅜ per cent certificates and 3½ per cent notes maturing November 15, 1959 were exchanged for the new issues; $7,037 million (including the $5 billion exchanged by the System) was exchanged for the one-year 4¾ per cent certificates and $1,329 million for the four-year 4⅞ per cent notes. Only $528 million of the maturing certificates and notes, or about 14 per cent of public holdings, were redeemed for cash. At the same time, holders of $1,683 million of the $2 billion 4 per cent notes due August 15, 1962 but redeemable at the holder's option on February 15, 1960 took advantage of the special offer allowing them to exchange the 4 per cent notes for the new 4⅞ per cent notes. Holders of $157 million of the 4 per cent notes that were not exchanged subsequently gave notice of their intention to redeem for cash on February 15, 1960.

The refunding was generally considered quite successful. However, the fact that investors subscribed for $3.0 billion of the new 4⅞ per cent notes, an amount greater than many market observers had expected, tended, by increasing the supply of 3- to 5-year maturities, to depress that area of the market. At the same time, the news that steel mills were reopening gave rise to some expectations of heightened demands for credit at a period of the year when other credit demands typically expand seasonally.

In reflection of these influences, prices moved generally down over the first ten days of the month but then advanced somewhat after the Veterans Day holiday on November 11. The advance was centered in the intermediate area, where some buying developed, apparently representing the demand side of tax switching. This rally, however, was of limited duration, with price declines reappearing after midmonth, reflecting in part selling by some investors preparing to take up new corporate bonds offered at higher yields as well as the uncertainties introduced by the approaching Treasury cash financing.

On the whole, the market reacted only mildly to the Treasury announcement on November 19 that it would seek $2 billion in cash through a 320-day bill issue, to be sold at auction on November 24. The market also took in stride the Treasury's announcement that $1,600 million in Series F and G Savings bonds issued in 1948, and maturing in 1960, could be exchanged between November 23 and 30 for 4¾ per cent Treasury notes maturing May 15, 1964. Nevertheless, prices of outstanding issues continued to show a downward tendency for the balance of the period, with changes over the entire month ranging generally from $\frac{8}{32}$ to $1\frac{4}{32}$ lower for notes and intermediate bonds and

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from $^{26}/_{32}$ to $1^{16}/_{32}$ lower for longer term bonds. By the close of the period, average yields on long-term bonds had risen to 4.19 or 9 basis points higher than at the end of October.

There were relatively sharp fluctuations in Treasury bill rates during the period; and, while rates declined on most days, they rose substantially on each of the regular weekly auction days as well as in the closing days of the period. Over the entire month, rate changes ranged from 8 to 45 basis points higher for most issues. The declines in rates, when they occurred, to an important extent merely reflected special demand factors, including the temporary reinvestment in bills of funds previously obtained from the capital market or through the sale or redemption for cash of "rights" in the Treasury's refunding. The underlying note of hesitancy in the market was in part attributed to the absence of a broadly based demand as well as to expectations of selling by corporations as well as by banks over the coming weeks—in turn related not only to the increased demand for credit stemming from the resumption of steel production but also to seasonal cash needs for tax and dividend payments. The hesitant tone also reflected the backwash of the Treasury's November financing and uncertainties regarding the impact of financing it may be required to undertake over the coming months. This general tone of caution found expression in each of the regular weekly auctions. The bidding was not aggressive in the November 16 and November 30 auctions, in which the average issuing rate for three-month bills reached new record highs of 4.332 and 4.501 per cent, respectively. This compared with a rate of 4.022 in the October 26 auction. The average issuing rate for six-month bills reached a level of 4.891 per cent on November 30 as compared with a 4.499 rate on October 26. Bidding in the special auction held on November 24 for $2 billion of 320-day bills was cautious—even though the commercial banks had the advantage of paying for the bills through credit to Tax and Loan Accounts—with the average issuing rate at 4.860 per cent. The market rate on the new special bill closed the month at about 5 per cent.

OTHER SECURITIES MARKETS

A generally steady tone characterized the corporate and municipal bond markets throughout most of November. The average yield on Moody's Aaa corporate bonds moved down by the end of the month to 4.54 per cent, a decrease of 2 basis points from the end of October, while the yield on similarly rated municipals declined to 3.38 per cent from 3.49 per cent.

A somewhat heavy atmosphere developed in the second week of November, reflecting market uncertainty related to the resumption of steel production, but subsequently the market was strengthened considerably by the successful sale of $250 million of American Telephone and Telegraph Company bonds. These 5⅜ per cent debentures (Aa-rated), reoffered to yield 5.22 per cent, were immediately sold out and quickly moved to a premium. Including this issue, corporate bond flotations in November aggregated $386 million, representing increases over both the October total of $298 million and the November 1958 total of $228 million. Most of the corporate offerings were well received. New municipal bond issues totaled $369 million, a decrease from the October amount of $529 million but only slightly lower than the $397 million sold in November 1958. Municipal flotations in general were accorded good receptions during the month.

Rates on commercial paper were increased ⅛ of 1 per cent on November 20 and again on November 30, bringing the offered rate on prime four- to six-month paper to 4⅞ per cent.

International Developments

BUSINESS TRENDS ABROAD

Economic activity is now at record high levels in the major industrial countries abroad. The vigorous economic expansion under way since the early part of this year has generally continued unabated in recent months, and in several countries has even accelerated. In a number of cases business investment in plant and equipment, which had not been a driving force in the earlier stages of the upturn, now appears to be picking up. On the basis of the current expansion, several European countries, as well as Canada and Japan, are expected to show rates of growth in 1959 that will be among the largest recorded since World War II. The current advance is being watched with some concern in an increasing number of countries, however, since it is now proceeding against the back-

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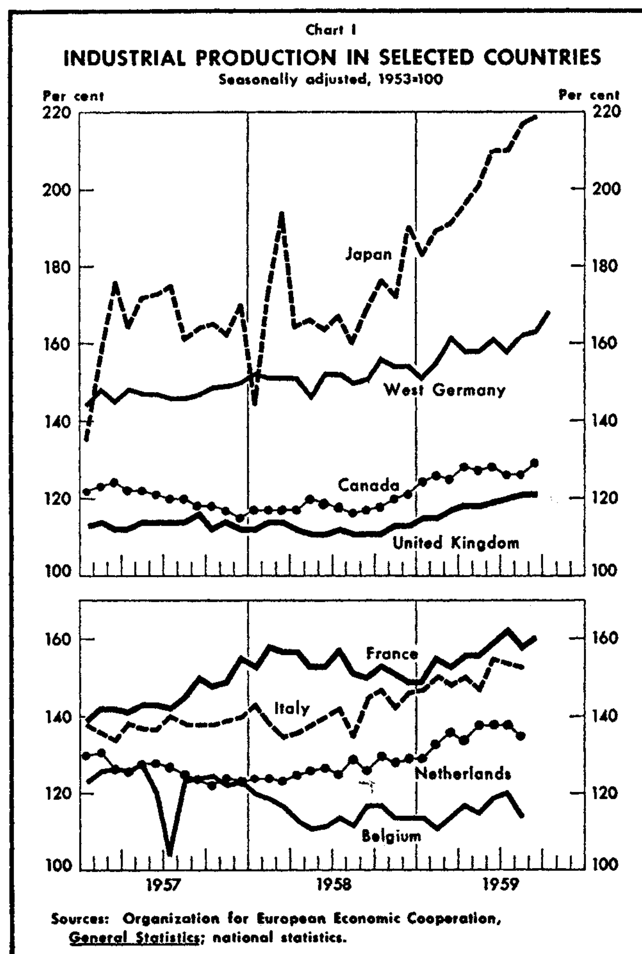
ground of near-capacity output levels, spreading labor shortages, and growing pressures on prices and wages. Although price and wage increases have thus far remained relatively small, they have nevertheless prompted countermeasures designed to preserve an economic environment conducive to continued growth. Confidence abroad therefore remains high that the present growth will not develop into an inflationary boom.

The strength of the economic upsurge abroad has been reflected in the continued rise of industrial output, which in most countries has set all-time records (see Chart I). Industrial output in Britain was about 2.5 per cent higher in the third quarter than in the second—7 per cent above the third quarter of 1958—and in October scored another advance. In France, where the economic upturn began only in the spring of this year, third-quarter industrial production was up almost 2 per cent from the second quarter and about 5 per cent above a year ago. Even in Germany, where output has been rising for about a year and capacity is almost fully utilized, the expansion continued unabated into October, with industrial production 3 per cent above September on a seasonally adjusted basis and 8 per cent above a year earlier. Industrial production in most of the other Western European countries, notably Denmark, Finland, Italy, and Sweden, as well as Japan, likewise reached new peaks in the third quarter. The recovery now also appears to have spread to Belgium, where the recession was more pronounced than in the other industrial countries abroad and lasted from the summer of 1957 to well into the first half of this year. In Canada, on the other hand, the vigorous business expansion, which had begun well before Europe's upturn, appeared to have leveled off temporarily during the summer. In September, however, industrial production recovered and reached an all-time high, bringing third-quarter output to a level 8 per cent above a year ago.

The current expansion in output is still largely concentrated in the basic and the consumer-durables industries, as well as in construction activity. During the third quarter, steel production recorded all-time peaks in France and Germany, stimulated in part by the high level of construction, and in the United Kingdom steel output in October rose to about 92 per cent of current capacity, its highest level since March 1958 and only slightly below the 1957 peak. Automobile output has continued to break old records, with production during the first ten months ranging from 10 to 13 per cent above a year earlier in the three major car-producing countries in Europe. The improvement in textile production, first noted in the spring, has continued and, judging from the large inflow of new orders, the industry now appears to be in a more



favorable position than in many years. Capital-equipment industries, while lagging somewhat behind the general upswing, have begun to show signs of renewed vigor, notably in the Netherlands and Germany. In the latter country, where the boom began relatively early, these industries reported an inflow of domestic orders in the third quarter 23 per cent above a year earlier.

Business investment in fixed capital, which thus far has not been a major element in the expansion, is now showing strength, as an increasing number of industries are beginning to operate at close to full capacity. Moreover, the increasing tightness of labor markets is also encouraging investment, since further production gains will have to be attained chiefly through higher labor productivity. The rise in investment outlays is particularly apparent in Germany, where a recent survey disclosed that private industrial investment this year would exceed that of 1958 by at least 8 per cent, whereas its provisional results had indicated an increase of only 4 or 5 per cent.

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In Japan the equipment-investment outlays of major industries are also increasing, and a further rise is anticipated. In the Netherlands, increased investment activity has been in evidence particularly in the chemical industry, which has benefited strongly from the boom. Private investment in Italy is expected to receive an important stimulus from the 300 billion lire ($480 million) government loan floated in July to promote public and private investment activity. In the United Kingdom, the Chancellor of the Exchequer recently stated that there were various signs that an upward trend in industrial investment was beginning to develop, though not at a spectacular rate so far. Such a trend could compensate for a leveling-off of consumer expenditures, which have been the major factor in the recovery but which, according to the Chancellor, would probably lose some of their strength. A similar combination of developments appears to have occurred, at least temporarily, in Canada, where retail sales showed no growth in recent months but gross fixed investment continued to increase despite a leveling-off in outlays for housing.

An important stimulus to the economic upswing abroad has continued to be provided by exports, which have benefited especially from increasing sales to the United States (see Chart II). In the first nine months of this year, exports to the United States by Japan were 54 per cent above a year ago and by Western Europe about 42 per cent, with Germany and the United Kingdom accounting for the bulk of the increase. The expansion of economic activity in the United States has undoubtedly been a major factor in this rise, although it may also reflect these countries' growing competitive strength. On the other hand, as the upturn in economic activity abroad has gathered momentum, these countries' imports have also picked up. Third-quarter imports by Germany, Italy, and the Netherlands were up by 10 to 20 per cent from 1958; French imports, however, remained below year-earlier levels until October. Imports from the United States have begun to rise in recent months, and this trend is expected to receive further support from the relaxation of restrictions against dollar imports recently undertaken by the United Kingdom, France, Italy, and Sweden, and currently planned by Japan and Germany.

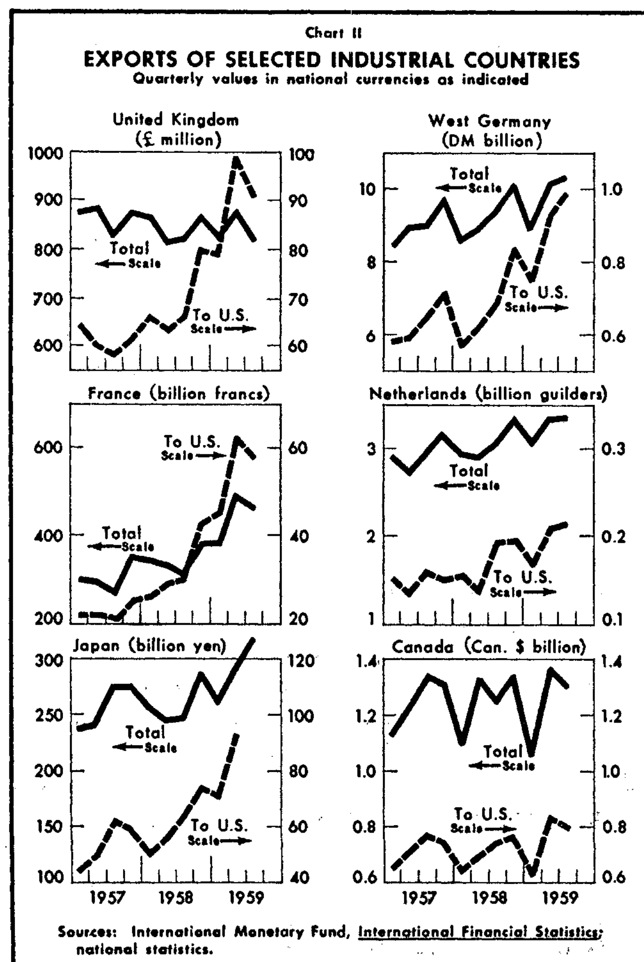
The continued expansion in production has pushed employment to high levels, with labor shortages developing in several industrial countries, notably Austria, Germany, and the Netherlands. Even in Denmark, insured unemployment in the second and third quarters of 1959 dropped to about 2 per cent of the labor force, the lowest level since the war, after having averaged about 5 per cent during these quarters in the previous three years. In the United Kingdom, third-quarter unemployment was also below the corresponding 1958 quarter but, in contrast to earlier years of rapid expansion, vacancies are still appreciably under the number of registered jobless. Unemployment has also declined in Belgium and Canada, although by only relatively small amounts.

Wage pressures, virtually absent during the first eight months of this year, have also begun to appear. In both Germany and the United Kingdom new wage claims have been made in important industries. A new labor contract in the Dutch metal industry included a 5 per cent pay boost, and is likely to set the pattern for other industries in that country. In Austria and Denmark, despite the absence of general wage adjustments, wages have been drifting upward in industries where labor shortages have appeared. In both Belgium and France, the retail price indexes rose sufficiently in the latter part of the summer to cause automatic wage increases; as a result, wages and government salaries rose 2½ per cent in Belgium during September and October, and the French

Chart II

EXPORTS OF SELECTED INDUSTRIAL COUNTRIES

Quarterly values in national currencies as indicated



Sources: International Monetary Fund, International Financial Statistics; national statistics.

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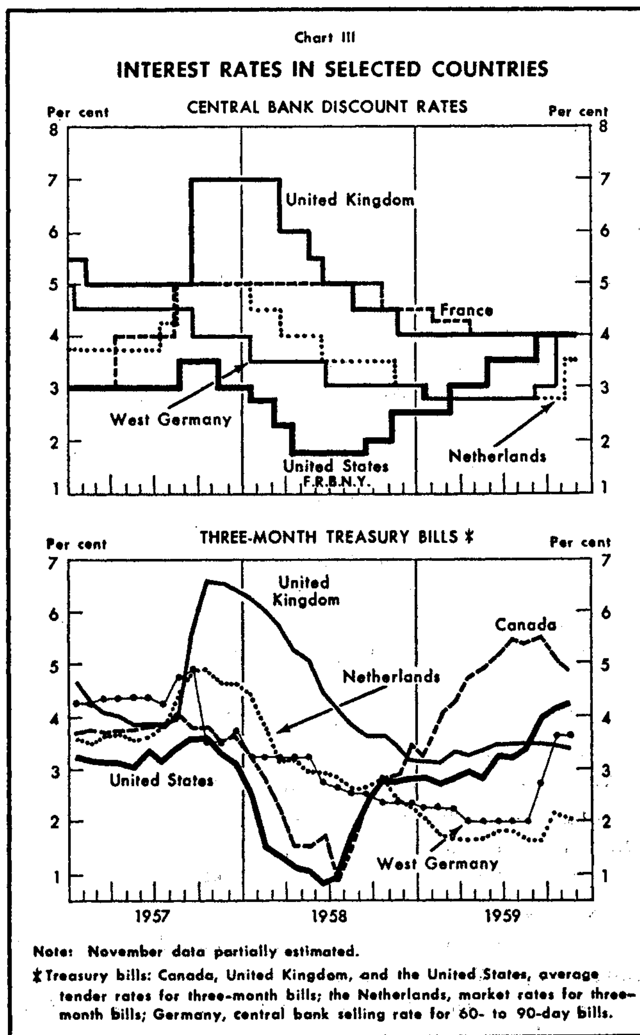
minimum wage was increased 2.66 per cent on November 1. The rise in labor productivity has, however, been strong and may well match the advance in wages over the year.

Consumer and wholesale prices, which had been generally stable during the first half of the year, have also advanced in most industrial countries abroad, with the notable exception of the United Kingdom where prices have continued to show a remarkable stability. On the Continent, food and farm prices were substantially higher in the third quarter, mainly because of this summer's long drought. Moreover, prices of various other consumer goods, including textiles, as well as of services moved upward during the quarter. In the Netherlands the cost-of-living index jumped sharply in July and August, and for the third quarter averaged more than 3 per cent above the corresponding 1958 quarter; similarly, in Germany this index had risen in October to 3.7 per cent above a year ago. In France, the wholesale price index increased nearly 2 per cent between July and September, in contrast to a decline during February-July, when increases in the prices of raw material and semimanufactured goods had been offset by a decline in agricultural prices. In Austria, wholesale prices rose 2.4 per cent in August over July, reversing the decline recorded earlier last summer. Although much of the over-all price advance in these countries has so far reflected the influence of the drought, there is growing concern that the moderate rise in nonfood prices may be a sign of inflationary pressures.



Note: November data partially estimated.
‡ Treasury bills: Canada, United Kingdom, and the United States, average tender rates for three-month bills; the Netherlands, market rates for three-month bills; Germany, central bank selling rate for 60- to 90-day bills.

MONETARY TRENDS AND POLICIES

With the reappearance of price and wage pressures in an increasing number of industrial countries, the shift toward monetary restraint became more pronounced. In September, the German Federal Bank increased its discount rate from 2¾ per cent to 3, thus becoming the first central bank abroad to raise its rate in the present upswing (see Chart III); it was shortly followed by the National Bank of Denmark. In October, the German commercial banks' rediscount ceilings at the German Federal Bank were reduced, reportedly by as much as two thirds for some banks, and the banks' minimum reserve requirements were increased by 10 per cent. Moreover, the German Federal Bank in that month again raised its discount rate, this time by a full point, bringing it to 4 per cent. With this increase the central banking systems in four major industrial countries, the United States, the United Kingdom, Germany, and France, now maintain the same discount rates, although as the chart indicates short-term interest rates continue to show significant differences. The Netherlands Bank in November lifted its rate to 3½ per cent "in view of strong and sustained credit expansion during recent months", the increase of ¾ per cent being relatively large in terms of the bank's postwar practice.

The Bank of Japan also moved in the direction of credit restraint, raising the discount rate on December 2 to 7.3 per cent from 6.935. In September, the Japanese monetary authorities had formally established minimum reserve requirements for commercial banks, under legislation enacted in 1957 authorizing the central bank, with the consent of the Ministry of Finance, to impose such requirements up to 10 per cent of demand deposits. Large banks are now required to maintain reserves, in the form of deposits with the Bank of Japan, equal to 1½ per cent of their demand deposits; for small banks the ratio is ¾ per cent. In addition, the Bank of Japan resumed sales of securities from its portfolio under repurchase agreements, in order to help slow the increase in the money

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supply that normally occurs at this time of the year. The Ministry of Finance, moreover, announced a tightening in stock market margin requirements to 70 per cent from 60, the fifth increase since June 1958; in Japan, as in other foreign countries, stock prices have been rising sharply.

In other industrial countries, even though no formal credit restraint measures were taken, a rapid growth in bank lending has also created some concern. The governor of the Swedish Riksbank requested the commercial banks to exercise greater restraint in extending credit, especially personal and consumer loans. He warned that, if the banks did not heed the Riksbank's recommendations, he would make use of the 1949 law authorizing the central bank to impose a 50 per cent liquidity-reserve requirement against all deposits; the commercial banks' informal minimum liquidity ratio had been raised on July 1 to 30-40 per cent, depending on the size of the institution. In Finland, the governor of the central bank stated that the bank would begin restricting its commercial lending activities, and called on the private banks to meet the expected further increase in credit demand without recourse to borrowing from the central bank. Even in England, where the authorities have not yet actually begun to restrain credit, the 30 per cent increase in advances by the London clearing banks during the year ended September 30 has called forth a first note of warning: the governor of the Bank of England, addressing the annual bankers' dinner at the Mansion House, recently cautioned that the rise in bank loans would "need watching if it should continue much longer at the same pace".

In Canada, on the other hand, the chartered banks' business loans declined by 4 per cent in the ten weeks ended November 18, following an unprecedented 25 per cent expansion during the first eight months of the year. Although the reasons for this decline are not yet clear, the governor of the Bank of Canada recently noted that "the United States steel strike may have caused a reduction of investments and bank loans in Canada" and that "the banks have already achieved a number of fundings of large loans (with more still to be expected)" following their decision last August to curtail further expansion in their lending. The banks have apparently not been reinvesting the funds obtained from the reductions in their loans and, as a result, have allowed their cash reserve ratios to remain at unusually high levels, averaging 8.3 per cent since mid-August as against the 8 per cent legal minimum. At the same time, a considerable easing has taken place in the money and capital markets, as the banks cut back their sales of government securities, which had been very large during the summer months, and as the Canadian Treasury stopped expanding the bill issue and on two occasions even reduced it. Reflecting this easing, the average Treasury bill tender rate dropped to 4.83 per cent on November 4 from a record high of 6.16 per cent reached on August 13; on November 26 the rate stood at 4.86 per cent.

EXCHANGE RATES

Spot sterling was generally lower in the New York foreign exchange market during November. Substantial commercial demand for United States dollars in London, occasioned in part by Britain's removal of most of the remaining restrictions on imports from the dollar area, depressed the rate from $2.8050 to $2.8020 early in the month. Subsequently, the rate moved between $2.8022 and $2.8044 until the month end, when Continental and commercial demand for dollars in London and commercial offerings of sterling in New York caused the rate to decline to $2.8012.

Reflecting an adjustment to the wider short-term interest rate differential between London and New York resulting from the advance in yields on United States Treasury bills, the premiums on three and six months' sterling were quoted up to 62 and 92 points, respectively, at midmonth, the widest since September 1951. On November 30 such deliveries stood at 51 and 81 points premium.

The Canadian dollar, under pressure of heavy commercial demand for United States dollars in Canada, declined from $\$1.05^{25}/_{32}$, quoted on November 2, and reached $\$1.04^{39}/_{64}$ shortly after midmonth. The rate subsequently improved as this demand tapered off, as grain interests made substantial purchases of Canadian dollars, and as the proceeds of a $20 million Canadian provincial issue that had been placed in New York were transferred. On November 30 the Canadian dollar was quoted at $\$1.05^{17}/_{64}$.

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Monetary Policy and the Balance of Payments

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I confess to a feeling of acute nostalgia as I participate in this National Foreign Trade Convention and recall all the earlier conventions I have attended—not in those days as a central banker but as an active practitioner in international commercial banking. In fact, for many years I had the honor of sitting as a member of this very panel and trying to answer searching questions, some of which might have worried an oracle. My role today is a good deal easier, for you have graciously allowed me to talk on a subject of my own choosing. Searching for a suitable subject for this audience of men and women well versed in all phases of international economics, I decided that the United States balance of payments is of such significance now that it can hardly be given too much consideration. And while it has had wide coverage in recent speeches and press reports, I thought you might like to have the point of view of a central banker. It seems to me clear that an effective solution of this balance-of-payments problem meshes closely with the domestic aims of sound monetary policy.

First, a word or two on the background of the problem. As has been said so often, this country has, in the past two years, faced an entirely new set of international economic conditions. The postwar era, the era of the dollar gap, is gone—and its disappearance is a most dramatic proof of the success of the Marshall Plan and our related efforts over the years to restore viability to the economies that had been severely damaged by the war. Our gold outflow and the rapid build-up of foreign-owned dollar balances have been the counterpart of a tremendous increase in the monetary reserves of foreign central banks and private holdings of dollars, especially in Europe—a development which helped to pave the way for the restoration of external convertibility for so many currencies at the end of last year. So I think we are warranted in a feeling of considerable satisfaction in having contributed to a better international financial structure. But naturally we must think also of what this outflow of gold and build-up of foreign-owned dollar balances have meant for our own economy and what they would mean if allowed to continue indefinitely.

* An address by Mr. Hayes before the Forty-sixth National Foreign Trade Convention, New York City, November 16, 1959.

In 1958 our adverse balance of payments amounted to about $3.4 billion. This year it is running at the rate of about $4 billion. Last year some two thirds of the balance took the form of a gold outflow, while this proportion may drop to about one third in 1959. Our monetary gold stock, at its present level of over $19 billion, approximately half of the Free World's monetary gold, still represents a very sizable cushion. But no objective observer would argue from this that we can face with equanimity anything like a $4 billion adverse balance continuing for an indefinite period. For one thing, there is always a possibility that the share of the balance taking the form of a gold flow might rise. Liquid dollar assets owned by foreign countries are now estimated at $17½ billion and will have risen in 1959 by well over $2 billion. Granted that a good part of this total represents working balances that will be required to finance international transactions, it is apparent that dollar balances of this magnitude indicate that we must conduct our affairs in such a way as to preserve a feeling of complete confidence in the dollar. Fundamentally, this means confidence in the dollar's ability to purchase goods and services at competitive prices.

In essence, this country's adverse balance represents the sizable difference between a reduced but still substantial favorable balance on private current account and a much larger net outflow of United States capital and government payments (including private capital, foreign aid, and military outlays abroad). Were it not for these heavy commitments for the defense and economic development of the Free World, we might be reasonably well satisfied with the present favorable balance for goods and services. But faced as we are with so large an outflow of capital, and of military and economic aid funds—even though it may be possible to reduce it over a period of years—we must perforce search for ways of enlarging much further the present favorable balance on current account. And this means above all keeping close control over our cost and price structure. It is here, of course, that monetary policy can have a significant influence; but it may also, as I shall suggest in a moment, have some effect in tempering the capital outflow.

Monetary policy in this country must of course be

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geared primarily to our own domestic needs. The achievement of economic growth at a sustainable rate, which in turn depends upon price stability, has been and remains our chief objective. I suppose it is conceivable that under certain circumstances this domestic objective might conflict with international considerations. There have been times in the past when restrictive credit measures in this country have been attacked abroad as placing undue pressure on foreign monetary reserves. But in the period we are considering—the past eighteen months—it seems clear that monetary policy has been serving both our domestic and our international needs.

Let's review briefly what monetary policy has done and what it has not done in this eighteen-month period since the bottom of the recession. First, "tight" money has not meant a scarcity of credit or capital to meet the needs of growing business. Business loans of commercial banks have risen at almost a record rate, while at the same time consumer and real estate loans have also been growing apace. New corporate bond offerings have been only moderately lower than in the record period of early 1958. New mortgages have been placed at an annual rate of $18 billion. And all this has occurred while the Treasury was financing a record-breaking peacetime deficit of $12.5 billion in fiscal 1959 plus a seasonal deficit of $7 billion in the first half of fiscal 1960.

Second, the tremendous growth of bank loans has not been reflected in any equivalent rise in the money supply. While loans were increasing at an annual rate of 10 per cent, the money supply was rising at an annual rate of about 3 per cent—a rate which may be considered reasonably in line with the normal long-term growth of the economy. The explanation lies in the consistent ability of the commercial banks, right up to the present time, and in the face of the heavy Government deficit, to be net sellers of Government securities, disposing of a good part of their large holdings accumulated in the easy-money first half of 1958. But this would not have happened unless the Federal Reserve had been exerting pressure on bank reserves, and the banks would not have found purchasers unless interest rates had risen to levels considered attractive by those purchasers. Thus, the upward trend of interest rates has been an essential element in an orderly and noninflationary financing of a rapid business recovery accompanied by a record peacetime budget deficit. And it is worth noting that even at their present level interest rates are not particularly high either in relation to the long-term historical record in this country or in relation to rates recently prevailing in other leading industrial nations.

Now this rise in interest rates has played some corrective role in connection with our balance-of-payments deficit and the gold outflow. The net outward movement of private United States short-term capital, which had reached sizable proportions in 1958, was reversed during the first half of 1959. Tighter conditions in our capital markets, moreover, also slowed offerings in the United States of foreign issues which are now running about 45 per cent below 1958 levels. At the same time, the rise in short-term and long-term interest rates here has stimulated efforts by American financial institutions to attract and retain in the American market the dollar balances accruing to foreign holders, thereby perhaps helping through the action of market forces to slow down the conversion of dollars into gold.

While it is less easy to demonstrate that our firm credit policy has helped our trade balance, I think there is no doubt that if, in an effort to keep interest rates down, we had added materially more than we did to bank reserves and thus had supported a materially greater increase in the money supply, we might well have experienced a rising cost and price trend which would have made American goods just that much less competitive in world markets. It is my hope that our firm credit policy has induced, and will continue to induce, greater caution on the part of the participants in industrial wage negotiations.

I think I should add that not only has monetary policy been having some effect on the balance of payments, but also the balance of payments has had some effect on monetary policy. Of course there is no immediate and automatic effect in the sense that a given payments deficit brings an automatic and equivalent tightening in credit conditions or credit policy. For one thing, to the extent that the deficit results in a piling-up of additional dollar balances or other dollar assets owned by foreign central banks or other foreign holders, the ownership of these balances or assets is merely shifted from domestic to foreign holders. Bank reserves—the base for the money supply—are not affected. Also, the change of ownership does not necessarily bring any great change in money velocity. And even to the extent that the payments deficit shows up in an outflow of gold, this is regarded by the Federal Reserve System, on a short-run basis at least, as only one of the many factors affecting member bank reserves; and if the net effect on bank reserves produced by all these factors taken together is not fully in accord with monetary policy, we can and do compensate through offsetting open market operations. In a smaller country, vitally dependent on foreign trade, it would be much harder to refuse to let a gold outflow affect domestic credit conditions—for the result might well be an acceleration of the loss of gold and a sharp shrinkage in the re-

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serve base. Fortunately for the United States, the magnitudes involved in our gross national product, our money supply, and our reserve base are still relatively large in relation to the balance-of-payments components. In effect, we do not let the gold outflow automatically tighten credit by reducing bank reserves and the money supply. This, however, is very different from saying that the Federal Reserve can or does blandly ignore the balance-of-payments deficit. We recognize it not only as a cause of drain on our reserves which cannot be allowed to go on indefinitely, but also as a highly useful indication of symptoms in our domestic economy that call for treatment.

Monetary policy is a necessary but by no means sufficient remedy for the weaknesses in our economy leading to a balance-of-payments deficit. Fiscal policy and debt management are of great importance. The vast improvement in the Federal budget in prospect for this fiscal year as compared with the last is making a most significant contribution to keeping our prices on a competitive basis. The same thing can be said of efforts to extend a larger portion of the Federal debt, which is admittedly lopsided in the direction of short maturities. The Treasury has been attacking this problem with courage and telling effect, and I fervently hope that we may soon see the end of artificial legislative restrictions on such debt extension—restrictions based on the mistaken belief that interest rate levels can be set by government fiat.

To be fully effective, monetary and fiscal policy must of course be accompanied by recognition on the part of both management and labor that they can no longer continue along the old path of inflationary wage settlements followed by sizable price increases. In the case of the steel industry, for example, it can hardly have escaped notice that foreign steel has been growing more and more competitive with our own both here and abroad. In many other segments of the economy, labor as well as management are perhaps becoming increasingly aware of this problem of foreign competition and its unavoidable implications for wage contracts and price policies.

In meeting foreign competition we have even more than cost and price relationships to consider. There is increasing need to tailor our products more effectively to the particular conditions, tastes, and quality preferences prevailing in foreign markets; this calls for the best we have in techniques of design and merchandising. And if effective competition price-wise is to be buttressed by effective competition product-wise, we have to have fuller knowledge of the needs and potentialities of foreign markets, as well as to exert a continuing and imaginative effort to sell and to stimulate new demand.

So far we have been discussing measures which we in the United States can take in certain areas to correct the balance-of-payments deficit. Before passing on to a brief review of other lines of corrective measures, I might merely mention certain "automatic" forces now in operation which will reinforce these deliberate efforts. The rapid accrual of reserves abroad permitted an easing of monetary conditions and thus helped set the stage for the industrial recovery and expansion now proceeding apace in most of Europe. This business boom should logically stimulate American exports to Europe. There are some signs that this is happening, although it is too early to say whether the better export level (after seasonal adjustment) of the third quarter marks the beginning of a sustained trend. On the other hand, interest rates in Europe have begun to rise and European authorities have begun to tighten credit policy in response to booming business conditions, and this may weaken the corrective influence on the payments deficit which has been exerted by the tendency for rates to move higher here while monetary conditions abroad have remained comparatively easy.

Foreign governments also have a role to play in remedying the imbalance by removing most of the remaining measures abroad which discriminate against American goods and services. As Dr. Jacobsson forcefully pointed out in his address to the Fund-Bank meeting, these measures were born in an environment of dollar scarcity which no longer exists. I was glad to note at the Washington meetings virtual unanimity on the part of the central bankers with whom I talked that dollar discrimination should be eliminated as rapidly as possibly. Britain and France have recently removed many of their discriminatory controls and the Fund's strong statement of a few weeks ago on this subject should bring further progress.

As for methods of reducing the net capital outflow from this country, Secretary Anderson has called for "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". Here again I was pleased to find virtually no dissent on this basic principle in talks with the central bankers of the industrialized nations. Implementing the principle, however, is less easy and clear-cut. In the area of joint action, the new International Development Association offers one promising answer. While differing views were expressed at the International Bank meetings as to the policies which the Association should follow in its lending operations, and some questions were raised about its capital structure, the sentiment generally was clearly in favor of the Association. The prospect that the Association will be under the direction of the International

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Bank would seem to constitute a most promising guarantee against unwise policies.

Another step intended to encourage greater sharing of the burden of providing foreign capital was the recently announced policy under which funds committed hereafter by the Development Loan Fund will be available, for the most part, only to finance American exports. While this move has been attacked as a reversion to a "buy American" program, my guess is that most of our friends abroad will understand that the purpose of this action was to encourage other industrialized countries to provide adequate long-term financing for the underdeveloped countries and thereby help to relieve the United States of the unduly heavy proportion of the aid burden which it has carried for so long. As the provision of long-term capital by foreign sources becomes more plentiful, the Free World can continue to move, but perhaps more rapidly, toward the kind of liberal economy that all of us have been trying to develop since the war—where both goods and capital should be obtainable in the cheapest markets for each. I suspect that many of the industrial countries will frankly espouse a policy of taking on a larger share of the foreign assistance burden, in order to assure continued progress toward this kind of world.

In the private sphere, as well, it is my hope that we shall see a resurgence on a large scale of long-term financing of the capital needs of the underdeveloped countries by international financial centers abroad. Over the past few years a great deal of thought and effort has been given to the problem of stimulating more private American investment abroad through special guarantees and tax concessions. Now I think we can all agree that we would like to see more of the total international flow of capital on a private basis and less on a government basis. But in the light of our present balance-of-payments position, I think there is perhaps less need (except in carefully selected cases) for special stimulants to induce private American capital to go overseas and more need for encouraging private capital in other financial centers to play an increasingly important role in financing economic growth and general progress in the less developed countries.

There are two ways of correcting our balance-of-payments deficit which I fervently hope will not receive public support. One would be to curtail overseas expenditures for collective defense and economic development so severely as to weaken the defense and progress of the Free World. A more balanced sharing with other developed countries of military and development financing programs need not diminish the total flow of funds for these purposes. In the case of economic development in particular, the total flow should in fact be enlarged so that we can make accelerated progress in raising the living standards of the less developed areas. This is a goal which merits personal sacrifice on the part of not only all Americans but also the citizens of the more prosperous nations abroad.

Secondly, I would be most unhappy if, as a result of the payments deficit, we in the United States who believe in a liberal economy should lose ground to the forces of protectionism and restrictionism which are always present in this country, as in others. I should be greatly disturbed to see an attempt to solve the problem by raising tariffs or establishing additional import quotas. Not only would such an effort probably prove abortive, by giving rise to countermeasures abroad which could prove at least as effective as our own; but the process of competing to erect higher barricades would also mean a major setback in the healthy postwar trend, in which American influence has been so strong, toward less restricted world trade, and would bring a general lowering of living standards in all countries. It would indeed be ironical if the United States were to adopt such practices at the very moment when most other countries—after years of active encouragement by the United States—have made significant steps toward a freer pattern of international trade and payments.

There is at present a disturbing tendency to revive demands in this country for tariffs sufficient to compensate for the difference in wage rates here and abroad. Such a move overlooks the whole classical theory of international trade—especially the valid principle that mutually advantageous two-way trade can perfectly well take place between a high-wage and a low-wage country if the comparative advantage of one country in producing some products is less than that in producing some other products. It also overlooks, as is so often the case, the benefit to the American consumer in obtaining a product from the cheapest available source. Changes in the flow of international trade, as in the flow of our own domestic trade, should be allowed to develop naturally with a minimum of government interference.

I think there has been a good deal of exaggeration of the sudden lack of competitiveness of American products in comparison with those produced abroad. Some of the commentators speak as if it were a brand-new discovery that our wage levels are several times as high as in other industrialized countries. This is not a new phenomenon. What *is* new is the degree to which foreign producers have improved their competitive standing through more modern plant and equipment, more efficient selling methods, and prompter delivery. (If we look merely at the trend of wage rates here and abroad, we find that it has been rising

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more rapidly abroad than here in the past seven or eight years—and this may well continue, given the world-wide tendency to try to emulate the American standard of living.) While we must keep a very tight rein on costs under these circumstances, I see much evidence that those continuing advantages which we have in over-all productivity can, if we handle our domestic affairs with restraint, make it possible to come close to balancing our international accounts while continuing to maintain a much higher average wage level than countries abroad. Is not that the advantage we gain, at the present advanced state of our economy, from being able to afford the enormous outlay that is made every year in the United States on research and development and on highly productive new equipment?

After viewing this balance-of-payments problem from many angles, I cannot escape the conclusion that the first line of effective attack is to maintain sound conditions in our own economy, including a competitive cost and price structure. It seems to me clear that this is what the world expects of us, and that such doubts of our policies as have been expressed abroad usually have involved questioning of our determination to pursue realistic and courageous policies to this end. The really important point is that there has not been and need not be any fundamental conflict between our international responsibilities and our responsibility for maintaining sound conditions in our own economy. The two objectives are furthered by the same program—and the need to help correct the balance-of-payments deficit has provided an added argument in support of policies that are needed in any case for our own domestic welfare. To put it another way, by following policies aimed at domestic price stability and lasting economic growth, we are simultaneously strengthening the dollar as a key currency in the whole financial structure of the Free World, and enabling our economy to contribute generously to the economic development of other countries. Despite all that has been said about concern for the dollar, here and abroad, the fact remains that dollar assets constitute a vast segment of international monetary reserves. In our efforts to keep the dollar worthy of this position, I am sure that we will have the support of all of you who are interested in enhancing this nation's leadership in an increasingly prosperous world.

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