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Contents

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The Business Situation

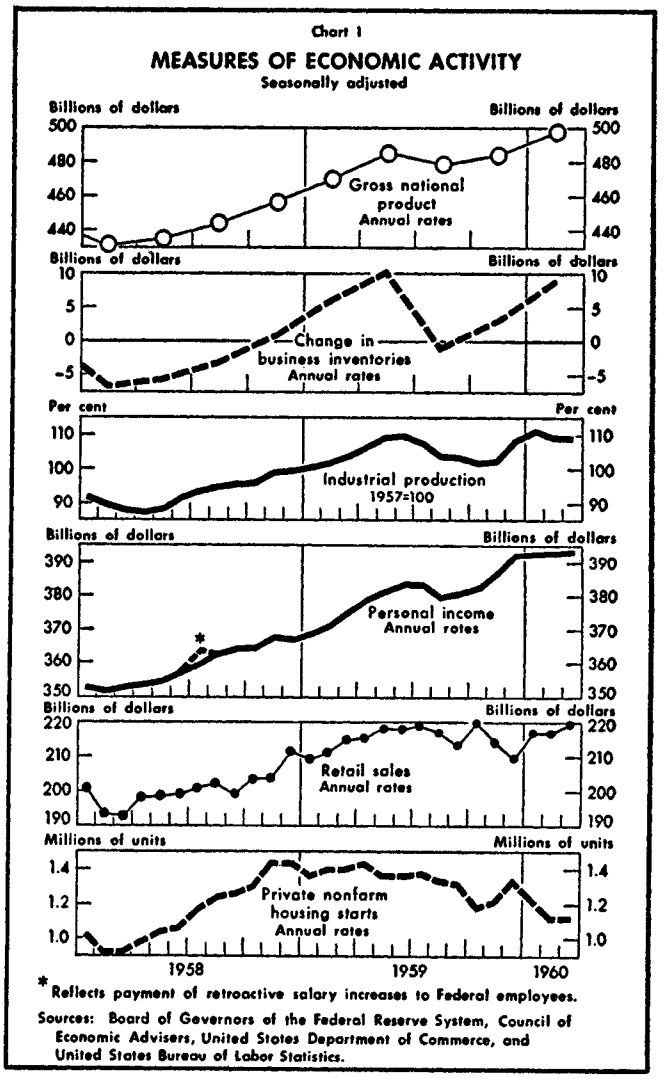
Preliminary information for April suggests that the economy has begun to pull out of its weather-influenced late-winter doldrums, although the evidence continues mixed. Consumer purchasing, in particular, brought a breath of springtime to businessmen. Automobile sales advanced smartly, and department stores reported a record Easter season. Industrial production may have steadied after two months of slight decline, a further downward pull of steel output from the very high post-strike level possibly being counterbalanced by firmness in some other lines. Hiring of workers for outdoor activities, postponed in blustery March, probably was made up in part in April, as winter turned abruptly into spring. Finally, a new survey of business investment spending plans, taken at the "high point of uncertainty" in March and early April, showed even larger planned outlays for 1960 than an earlier survey made only a few months ago.

THE PATTERN OF DEVELOPMENTS

During the first quarter of the year, despite the slight weakness in industrial production in February and March following the January record high, and in the face of a decline in stock market prices, gross national product rose 3 per cent to a seasonally adjusted annual rate of $498.0 billion (preliminary estimate; see Chart I). Measured in constant dollars, this was about 1½ per cent above the previous peak, reached in the second quarter of 1959, just before the steel strike. Slightly more than half of the $14.5 billion advance in the first quarter this year was in investment. Accumulation of business inventories accounted for most of this investment, the bulk comprising steel, automobiles, and other durables. The January-March quarter witnessed gains in the government, international, and consumer sectors of the economy, too. Of these, consumer spending showed the largest increase—$3.8 billion—with the major part being for services.

The industrial production index slipped again in March by one point, as it had in February, dropping to 109 (1957 = 100) compared with the January peak of 111 (see Chart I). The output of equipment remained unchanged at last summer's record level of 103, and the materials index was steady at 109. But the production of consumer goods edged downward again, the one-point decline bringing the series 2½ per cent below the record 116 attained in January. Reductions were recorded in the output of automobiles and of appliances and other house furnishings; only the production of consumer staples remained unchanged. During April, steel output was much below March levels, and there were scattered reports of contractions in other manufacturing fields. However, these movements may have been largely countered by increases elsewhere.

The decline in industrial production during March played some part in depressing employment, contraseason-



ally, by slightly more than a quarter of a million persons to 64.3 million, and in raising the rate of unemployment (percentage of the civilian labor force) from February's 4.8 per cent to 5.4 per cent, seasonally adjusted. Much more important, however, was the disruptive effect of the inclement March weather on agriculture and construction. Construction employment alone dropped by 224,000 persons, seasonally adjusted, more than the net decline in total nonfarm employment (Bureau of Labor Statistics series) of 214,000 persons. Employment in manufacturing and other sectors fell more moderately than in construction. And the contraction in private employment was partly offset by a rise in government employment, mainly because of temporary hirings for the 1960 Census. The more seasonable weather of April probably brought a larger-than-usual increase in employment, as work got under way on delayed outdoor activities, but it did not seem likely that unemployment would recede to the level reached in February, when the seasonally adjusted rate had for the first time in nine months dipped to (and even slightly below) the 1959 low.

The March drop in employment was accompanied by a slight shortening of the workweek (partly because of storms and partly because of reduction of overtime—mostly in automobile and other consumer goods plants). These factors, together with a further decline in farm income, served to hold personal income to a relatively small increase. The seasonally adjusted gain of $0.5 billion (annual rate) was larger than the previous month's advance of $0.2 billion (see Chart I), but smaller than any other monthly increase since 1958. (In mid-1959 there were of course two months when income declined because of the steel strike.) Wage and salary disbursements in the manufacturing and other commodity-producing industries actually fell, for the second successive month and by twice the loss in February. The decreases in personal income were slightly more than offset by advances in unemployment insurance and other transfer payments, in interest income, and in government wages and salaries (which included payments to temporary Census workers).

Accompanying the increase in total personal income, and despite the effects of bad weather, total retail sales moved a little higher in March to virtually regain the record level of last October (see Chart I). The gain in March was attributable entirely to an increase in nondurables. A very slight decline in durables seems to have been largely associated with the fall in home building that began last spring. Purchases at lumber, building, hardware, and furniture and appliance stores continued to fall off in March, while concurrently there were gains at food and general merchandise stores. Sales of automobiles in March rose markedly over February in number of units, although the gain in dollar value was probably less strong. An increasing share of sales consisted of the lower priced compacts; moreover, effective prices of practically all lines of cars seem to have been reduced as more generous discounts were offered in an effort to boost sales.

In April, the available evidence suggests, total retail sales took an even more favorable turn. Department store sales advanced during the first three weeks of the month—even after allowing for the special boost given to sales by the Easter holiday. Auto sales moved up more than seasonally during the first ten days of the month, compared with the parallel period of March, and again during the second ten days. Further surveys of consumer spending expectations confirmed a favorable outlook.

Spending still is unusually low relative to income, however. This lends support to expectations of an improvement in demand, although the flattening-out of income in the past few months, and particularly the weakness of wage and salary incomes, could have a dampening effect. The apparent slowing of the downward movement of residential construction that has been under way, with only a brief interruption, since last summer may also be interpreted as a sign of potential strengthening of demand for home furnishings and appliances. Although March and April residential construction outlays declined again, the seasonally adjusted level of housing starts in March remained steady despite the harsh weather (see Chart I). Continuing easing of mortgage funds and the lowering of downpayment requirements for mortgages insured by the Federal Housing Administration contributed to the expectation of an actual improvement in this sector. At the same time, there have been indications that the number of apartment vacancies has increased somewhat.

While it is unlikely that inventory accumulation will provide as great a stimulus to economic activity in the current quarter as in the first three months of the year, businesses will probably continue adding to stocks. In particular, stepped-up consumer demand may prompt businesses to increase their holdings, for in recent months inventory-sales ratios have been near last spring's low levels, which were the lowest since 1950. Several factors, however, militate against a very large increase in inventories unless demand surges strongly upward. There is, first, an apparently rapidly spreading trend, aided by electronic computing devices, toward better control of inventory levels. Secondly, relatively high interest rates may reinforce management's determination to keep inventories down to minimum levels. Thirdly, increased capacity in various producer goods fields en-

courages firms in the more advanced processing stages to expect rapid filling of their orders. Such inventory policies probably force the manufacturers of materials and other producer goods to keep somewhat larger inventories than they otherwise would, especially if they must compete for customers. Nevertheless, this more or less hand-to-mouth inventorying must be expected, if practiced on a wide enough scale, to lead to a more immediate, closer relationship between unforeseen changes in demand for final products and changes in demand for materials than would otherwise be the case.

Business plans for plant and equipment expenditures provide another encouraging note. The latest McGraw-Hill survey indicates that their respondents are now planning outlays for 1960 at a rate 16 per cent above the 1959 level. This compares with a much smaller 10 per cent rise in planned expenditures reported by McGraw-Hill in its preliminary survey last fall, and a 14 per cent increase projected in the recent Securities and Exchange Commission-Commerce Department survey. The latest McGraw-Hill survey was taken in late March and early April. This was a time when widespread disappointment about the pace of economic activity could have been expected to dampen spending intentions. The survey was also favorable in that it indicated a continued concentration of planned expenditures on modernization equipment as against expansion of capacity. This augurs well for the future, since modernization expenditures are likely to be maintained even if ample or excess capacity should develop at some time in certain sectors. Additional support for capital expenditures may come from the fact that profits in the first quarter of 1960 were, according to reports published thus far, close to the record level reached in the second quarter of 1959.

The industrial commodities component of the wholesale price index has remained relatively stable. The index for such commodities inched downward in February and March from the January record high of 128.8 (1947-49 = 100) to 128.6 at the end of the quarter, and during the first half of April prices changed little. The index of all wholesale prices, however, rose $\frac{7}{10}$ of a point in March to regain the April 1959 record high of 120.0—a result largely of higher farm and food prices. These price increases were in part seasonal, but March's unusually wintry weather helped push up livestock, meat, and egg prices. The consumer price index rose $\frac{1}{10}$ of a point in March to a new high of 125.7. As with wholesale prices, there was a more-than-seasonal increase in food prices, and most other components of the index also advanced. Automobile prices, however, declined substantially.

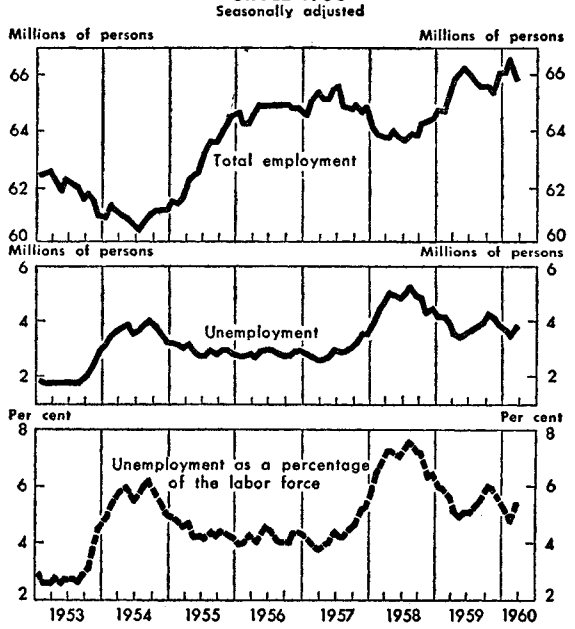
THE LONG-RUN UNEMPLOYMENT PICTURE

Total employment was at an all-time high in February, seasonally adjusted, before the raw March weather contributed to a sharp decline (see Chart II).[1] But unemployment remained relatively high in both months. In February, the number of jobless workers seeking employment was still 30 per cent larger than at the low point of the prior expansion (see Chart II), and more than twice as high as at the low point of the Korean war. The unemployment rate, which measures unemployment as a proportion of the civilian labor force, has continued for almost two and a half years at levels in excess of 4.7 per cent.

Some observers have suggested, in fact, that unemployment rates have drifted higher over the past decade as part of a long-term trend. If there is such a trend, it would appear to be somewhat more pronounced for periods of recovery and expansion than for the months of recession.

[1] See the March 1959 issue of this Bank's *Monthly Review* for a description of the technical features of the various statistical series of employment and unemployment.

Chart II
EMPLOYMENT AND UNEMPLOYMENT CHANGES SINCE 1953
Seasonally adjusted

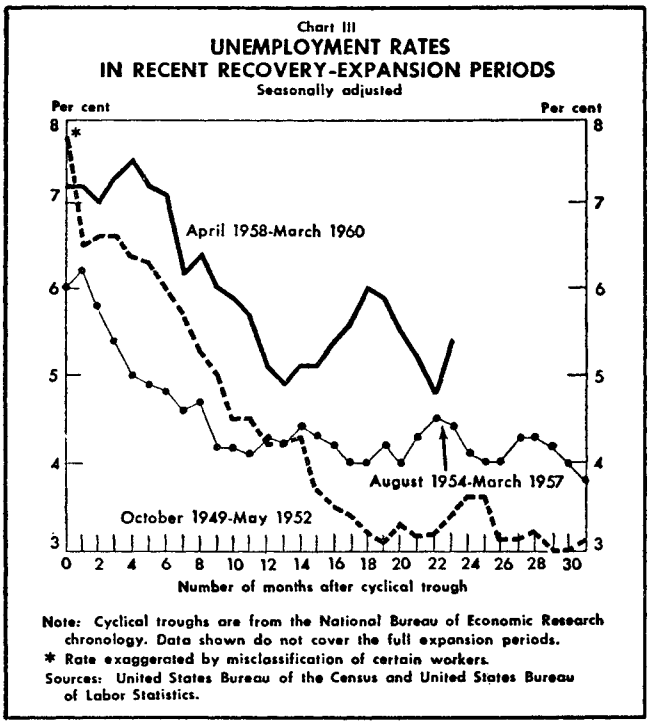


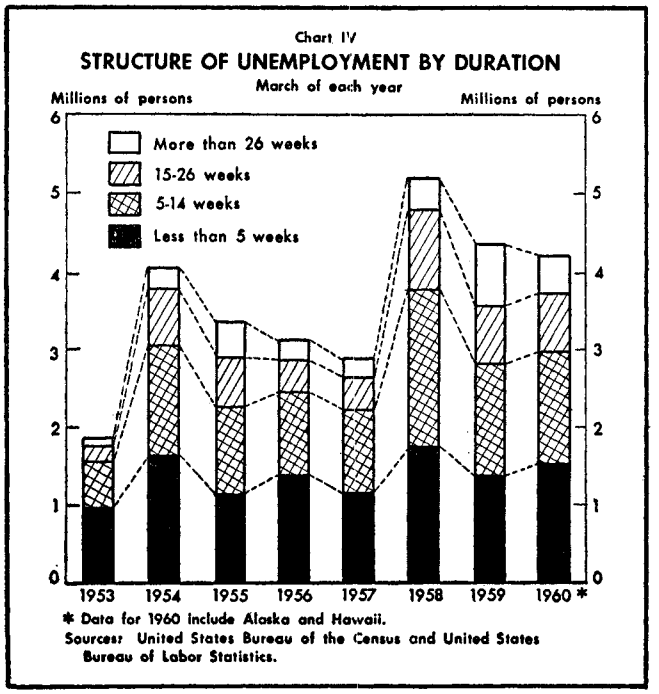
Note: Data include Alaska and Hawaii beginning January 1960. The inclusion of these two States added 266,000 persons to total employment in that month, mostly in nonagricultural industries. Unemployment level and rate were virtually unaffected.

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

An upward movement is apparent in Chart III, which shows the unemployment rates in each of the last three postwar recovery-expansion periods. The principal aberration from the indicated upward cycle-to-cycle trend, which occurred during the second half of 1954 and early 1955, can perhaps be explained by the large number of men in the armed forces who, if they had been mustered out earlier, would have swelled the total of unemployed; but this must at best remain conjecture. Indeed, we probably do not have sufficient evidence to establish either the presence or absence of a clear-cut trend. The period involved is relatively short, and in any case interpretation of the years in it is clouded by the beginning and ending of a major military conflict.

Whether or not there is an upward trend in the rate of total unemployment, a rather striking change within the total may be seen in the rising number of long-term unemployed, i.e., those idle for fifteen weeks or more at a time (see Chart IV). In 1953, this group was 15 per cent of the total unemployed. In the seven years since then the rate of long-term unemployed has never fallen below 22 per cent of the total, and in four of those years has actually accounted for between 28 and 35 per cent. In addition, those who were out of work for more than twenty-six weeks rose from 5 per cent of the total unemployed in 1953 to as high as 18 per cent in 1959.





Who are these long-term unemployed? Many of them are workers forty-five years and older, or members of nonwhite minorities. In terms of their economic position, many are workers who have experienced "structural" unemployment. The causes of such dislocations exist in years of prosperity as well as in years of recession; they include long-term declines of industries and of occupations, the displacement of old products by new ones, changing consumer tastes and changing Government defense programs, and automation and other technological developments. The effects of structural dislocations are particularly strong in areas where a formerly dominant industry has declined. Such areas may even become chronically depressed, with ramifying influences on local service, construction, and transportation industries. The more mobile, younger workers can migrate from the area on relatively short notice, and many do. Older workers, probably most of them heads of families and many of them possessing skills for which there is no longer much demand, are less quick to move and tend to try to wait out what may sometimes appear initially to be a temporary shutdown. In the high employment period of June 1956-June 1957, unemployment in chronically depressed areas accounted for at least one fifth of total unemployment; and more than one fourth of the unemployed in these areas were out of work for six months or more, compared with only about half that percentage elsewhere. In May 1959,

before the steel strike, almost 15 per cent of the nationwide unemployed were located in such areas. Most of these areas were concentrated in eight states, with Pennsylvania and Massachusetts topping the list.[2]

Areas with relatively high levels of unemployment are not, of course, limited to the chronically depressed areas. In March 1960 there were 33 major labor market areas, out of a national total of 149, that were designated "surplus labor market" areas by the Bureau of Labor Statistics. These surplus areas had high unemployment (i.e., more than 6 per cent of the civilian labor force) primarily for reasons other than seasonal or temporary influences, and either had experienced these levels for more than four months or were expected to do so. A year earlier there had been 72 such areas, so that by March of this year the number of communities still in this condition had been reduced by more than half. It is well to recognize, however, that these remaining pockets of "surplus" labor represent close to one fourth of the country's major labor market areas.

The relatively short-term unemployed, i.e., those who were unemployed for less than fifteen weeks in any one spell, accounted in the prosperous years 1955-57 for about 75 per cent of the unemployed. About a fifth of the short-term unemployed were workers who were voluntarily shifting from one job to another. Many of these, however, were "repeats", indicating that a much smaller number of individuals were involved in such voluntary shifts than the proportion might suggest. About another 40 per cent of the short-term unemployed represented new workers just entering (or re-entering) the labor market. And 40 per cent or more were workers affected by seasonal fluctuations in employment. As Chart IV shows, short-term unemployment has grown in absolute level during the 1950's, comparing recession year with recession year and prosperity year with prosperity year—even though declining as a percentage of the unemployed.

The future may well bring other problems. During the 1960's, according to Department of Labor projections, 26 million young people will enter the labor force, 37 per cent more than entered during the 1950's, and 3 million women will return to the labor force. Withdrawals from the labor force are expected to offset only about half of this total increase. The new entrants to the labor force will of course be consumers too, and perhaps aggressively so if the current practice of early marriage and household formation continues. Nevertheless, it is quite clear that employment opportunities will have to be expanded considerably more rapidly than heretofore, if the number of unemployed is to be kept from swelling. The country will also be confronted with the special unemployment problems arising from the need for higher labor skills to cope with the more complex machinery that is being widely introduced, the need to retrain older workers who are a major part of the long-term unemployed, and the need to ameliorate conditions in chronically depressed areas. None of these problems, however, should be viewed as a cause for grave alarm. They are, in fact, the problems of a society that not only is expanding in size but also is growing in technology, extending its life span, and developing increasing recognition of social responsibilities.

[2] The criterion used by the Department of Labor in determining whether an area is chronically depressed is, in general, the persistence of unemployment rates 50 per cent or more above the national average for four of the preceding five years.

Money Market in April

The money market tone was somewhat easier in April than in other recent months, while member bank reserve positions, in the aggregate, were under moderate restraint. Partly because of the easier availability of funds at the money market banks, Federal funds traded at rates below the 4 per cent discount rate during part of each statement week. Rates on loans to Government securities dealers at the New York City banks ranged from 4 per cent to 5 per cent during the month.

Market rates of interest on most obligations moved significantly higher in the first half of April, after declining almost steadily during the first three months of the year. Later in the month, rates moved irregularly lower again, although most issues showed a net rise in yield over the month as a whole. The rate advance probably was attributable to a number of influences. Treasury financing was an important factor, as the Treasury marketed $2.6 billion of notes and bonds to raise new money and sold $2 billion of one-year bills to replace a maturing issue. Offerings of new tax-exempt securities also expanded. And

of some importance in influencing interest rate developments was the apparent improvement in the business climate during the month.

MEMBER BANK RESERVES

Member bank borrowing from the Federal Reserve Banks averaged $615 million during the four statement weeks ended in April, compared with $661 million the previous month, while average excess reserves were virtually unchanged at $427 million. As a result, net borrowed reserves averaged $188 million, somewhat lower than the $235 million for the five statement weeks ended in March.

During the first two statement weeks, reserve drains resulting from the pre-Easter expansion of currency in circulation were offset by the effects of lower required reserves and by System open market operations. A sharp increase in required reserves during the third statement week—reflecting heavy bank purchases of the new Treasury notes—plus reserve drains from some operating factors were only partially offset by a larger-than-usual midmonth rise in float. System open market operations provided $305 million of reserves during this statement week, of which $173 million was through repurchase agreements. In the final statement week the termination of these repurchase agreements and a decline in float—which remained, however, at an unusually high level—served to offset reserves released by the post-holiday reduction of currency in circulation and a decline in Treasury deposits at the Federal Reserve Banks.

Over the four statement weeks, from March 30 through April 27, Federal Reserve holdings of Government securities rose by $224 million, as securities held outright by the System Account were increased by $194 million and repurchase agreements rose by $30 million.

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, April 1960

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

Factor	Daily averages—week ended				Net changes
	April 6	April 13	April 20	April 27	
Operating transactions					
Treasury operations*	− 14	+ 53	− 196	+ 111	− 46
Federal Reserve float	—	+ 12	+ 481	− 232	+ 261
Currency in circulation	− 119	− 174	− 1	+ 246	− 48
Gold and foreign account	+ 38	− 49	+ 4	− 11	− 18
Other deposits, etc.	− 26	+ 32	− 46	+ 180	+ 140
Total	− 122	− 127	+ 242	+ 295	+ 288
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 30	+ 21	+ 132	+ 27	+ 210
Held under repurchase agreements	+ 15	+ 91	+ 173	− 207	+ 72
Loans, discounts, and advances:					
Member bank borrowings	+ 102	− 33	− 110	− 37	− 78
Other	+ 25	+ 31	− 62	—	− 6
Bankers' acceptances:					
Bought outright	—	—	− 2	− 1	− 3
Under repurchase agreements	—	—	+ 7	− 7	—
Total	+ 172	+ 111	+ 136	− 224	+ 195
Member bank reserves					
With Federal Reserve Banks	+ 50	− 16	+ 378	+ 71	+ 483
Cash allowed as reserves†	− 76	+ 18	+ 32	− 8	− 34
Total reserves†	− 26	+ 2	+ 410	+ 63	+ 449
Effect of change in required reserves†	+ 102	+ 27	− 512	+ 15	− 368
Excess reserves†	+ 76	+ 29	− 102	+ 78	+ 81
Daily average level of member bank:					
Borrowings from Reserve Banks	704	671	561	524	615‡
Excess reserves†	437	466	364	442	427‡
Net borrowed reserves†	267	205	197	82	188‡

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 April 27, 1960.

GOVERNMENT SECURITIES MARKET

The main feature of the Government securities market during April was a reversal in the first half of the month of the upward trend of securities prices that had predominated since early in the year. Prices were mixed in the last half of the month, with intermediate- and long-term issues moving slightly lower while most shorter maturities recovered part of their earlier losses.

Early in the month attention centered on the Treasury's cash offering of about $2 billion of a 4 per cent 25-month note and of up to $1.5 billion of a 4¼ per cent 25-year bond callable after fifteen years; subscription books were open April 4 and 5 with delivery on April 14. The new bonds, offered at the maximum interest rate for marketable Treasury bonds permitted under present legislation, attracted only $370 million in public subscriptions, all of which were allotted in full. An additional $100 million was allotted to Government investment accounts. The bonds reached a low of 98½ bid in when-issued trading on April 12 and closed the month at 99.

Interest in the new notes was far stronger, particularly among the commercial banks, which were permitted to make 75 per cent of their payments with credits to Treasury Tax and Loan Accounts. Public subscriptions totaled $6.7 billion, and allotments—which were made in full for subscriptions up to $100,000 and on a 30 per cent basis above that amount—came to $2.2 billion. An additional $27.4 million was allotted to Government investment accounts. Moderate liquidation of the new notes during the balance of the month met with little offsetting demand in the secondary market, however, and the price dropped below par, reaching a low of 99 3/16 and closing the month at 99¼.

The minimum response to the new bonds, plus a growing feeling that the market may have overdiscounted

the slackened pace of economic expansion during the first quarter, brought an atmosphere of heaviness to the market. Contributing further to this atmosphere was the oncoming April 12 auction of $2.0 billion in one-year Treasury bills to replace the bills maturing April 15. In these circumstances, the regular weekly auction on April 11, for bills requiring payment on the same day as the new notes and bonds, resulted in issuing rates well above those obtained a week earlier. From eleven- and fifteen-month lows—of 2.731 per cent for 91-day bills and 2.927 per cent for 182-day bills—reached the previous week, average issue rates jumped by 89 and 93 basis points, respectively, to 3.622 and 3.854 per cent. Dealer resistance in the following day's auction of one-year bills was heightened by concern over the Good Friday payment date, which was a legal holiday in many States, with many of the dealers' regular financing sources scheduled to be closed. The one-year bills were auctioned at an average yield of 4.608 per cent, with awards at yields as high as 4.740 per cent.

With the Treasury's cash financing out of the way, short-term rates moved irregularly downward as substantial non-bank demand appeared for the new higher yielding bills. Later in the month, additional demand appeared on "swaps" out of issues maturing in mid-May. The one-year bills were trading at 4.37 per cent on a when-issued basis on April 14, and in the April 18 auction the average issuing rates declined to 3.306 per cent on 91-day bills and to 3.705 per cent on 182-day bills. The 91-day bill rate rose slightly to 3.317 per cent in the April 25 auction, while the rate on the 182-day bills showed no change. Market rates for bills, for the entire month, were generally 5 basis points lower to 25 basis points higher. Three-month and six-month bills closed at 3.04 and 3.42 per cent, respectively, while the new one-year bills ended the month at 4.07 per cent.

Prices for intermediate- and long-term Government securities, correspondingly, declined considerably by mid-month but were relatively stable thereafter, with price movements confined to a narrow range. Trading was very light, as the market marked time awaiting announcement of the Treasury's May refunding. For the month, prices of intermediate notes and bonds were mostly $\frac{1}{32}$ to $1\frac{9}{16}$ points lower while long-term bonds, which are competitive with the new 4¼ per cent bonds, generally were lower by 1¼ to 2 points. The average yield on long-term bonds had climbed to 4.20 per cent by the close of the period from 4.04 per cent at the end of March, while the average yield on issues due in three to five years had risen to 4.40 per cent from 4.06 per cent.

The Treasury announced after the close of business on Thursday, April 28, that holders of $6.4 billion of Treasury notes and certificates maturing May 15 will be offered in exchange a 4⅜ per cent certificate of indebtedness maturing in one year and a 4⅝ per cent Treasury note maturing in five years. Subscription books for the exchange will be open on May 2 through May 4, and delivery of the new issues will be made on May 16. The announcement met a generally favorable market reception.

OTHER SECURITIES MARKETS

The markets for corporate and tax-exempt bonds followed roughly the same pattern during April as the market for Governments. Prices of seasoned corporate and tax-exempt securities tended downward during the month, reflecting, in addition to the influences that were operative in the Government securities market, an inventory of recently offered corporate issues still available from underwriters and an increased supply of new State and local government offerings. Activity in these markets was irregular, as investors appeared first to hesitate and then to return aggressively in response to more attractive yields on new issues and on recent issues repriced following the termination of their underwriting syndicates. Over the month, the average yields on Moody's indexes for Aaa bonds rose from 4.45 to 4.46 per cent for corporates and from 3.28 to 3.34 per cent for tax-exempt securities.

Flotations of new tax-exempt securities totaled $633 million during April, more than the $491 million total in March but below the $831 million sold in April 1959. The new tax-exempts were accorded mixed receptions. Included among the new issues was an offering of revenue bonds by the Triborough Bridge and Tunnel Authority, consisting of $74 million of 4 per cent bonds maturing in 1985 and $26 million of 3½ and 3¾ per cent bonds due 1970-75. Reoffered at par, this issue was very well received.

The volume of new corporate securities offerings during April was $340 million, about the same as the $338 million offered in March but more than the April 1959 total of $298 million. Most issues were accorded poor receptions until late in the month when demand picked up considerably in response to higher yields.

In the market for short-term debt instruments, rates were adjusted upward following the sharp rise in Treasury bill rates. Dealers in commercial paper, who had reduced rates by ⅛ per cent on April 6, increased rates in two ⅛ per cent steps on April 12 and 18, bringing the offered rate on prime 4- to 6-month paper to 4¼ per cent. Dealers in bankers' acceptances raised their rates by ⅛ per cent on April 11 and by another ¼ per cent the fol-

lowing day, making the new bid rate on 90-day unendorsed acceptances 4⅛ per cent. Rates on directly placed sales finance company paper were increased by ¼ to ⅜ per cent on April 12, with the new rate on 60- to 89-day paper at 3¾ per cent. These rates were unchanged over the remainder of the month.

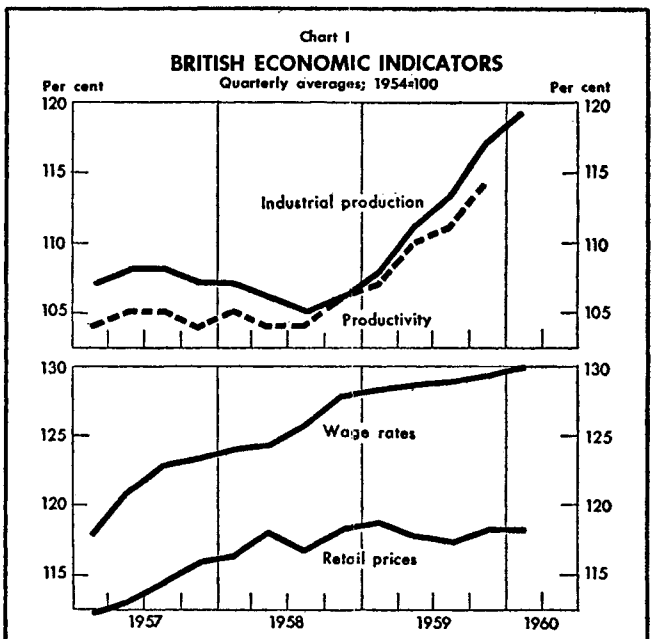
On April 18, the Federal National Mortgage Association launched a new program for the sale of short-term discount notes having flexible maturities to supplement its existing longer term debenture financing. Investors are allowed to select their own maturity dates within four designated series of notes ranging in term from 30 to 270 days. The notes were sold initially at discounts of 3.45 per cent for 30 to 59 days, 3.70 per cent for 60 to 89 days, 3.80 per cent for 90 to 179 days, and 4.05 per cent for 180 to 270 days.

International Developments

CHANGES IN BRITISH FINANCIAL POLICIES

After more than a year of rapid economic growth and nearly two years of virtual price stability, Britain is again confronted with rising inflationary pressures. Since the beginning of 1960 the authorities have accordingly been shifting their financial policies from ease toward restraint. In this, their aim has been to help assure the continuance of Britain's economic growth by moderating the expansion to a rate that is consistent with the maintenance of both internal price stability and the strength of sterling. This shift toward restraint is being continued under policies that were proposed to Parliament by the Chancellor of the Exchequer in his April 4 budget address and that were implemented in part toward the end of that month.

The Chancellor presented the budget against a mixed economic background of rising domestic prosperity and a weakening in Britain's balance of payments. Partly as a result of official measures adopted in 1958 and 1959 to stimulate the domestic economy, the seasonally adjusted index of industrial production had risen 13 per cent in the sixteen months ended February 1960 to a level 9 per cent above the previous all-time peak (see Chart I). The production rise was associated with a relatively small increase in total industrial employment and a large rise in labor productivity. At the same time, wage rates rose very little and the increase in earnings, while significant, was in the Chancellor's view "much nearer than in any other recent year to the rate at which increased productivity could enable us to continue expansion in the long term without inflation". Indeed the sharp rise in productivity combined with the moderate earnings increase was, the Chancellor said, "the biggest single contributory factor in the price stability of the past year". Emphasizing the "tremendous benefit" of price stability not only to those who live on small fixed incomes but "in the success of our exports", the Chancellor affirmed that its "continuance must be one of the main objectives of our policy".



Note: Industrial production: seasonally adjusted industrial production index, first-quarter 1960 figure based on January-February only. Productivity: seasonally adjusted index of output per person in industry. Wage rates: index of weekly wage rates, first quarter 1960 based on January-February only. Retail prices: index of retail prices.
Source: National Institute of Economic and Social Research, Economic Review, September 1959 and March 1960.

While the Chancellor expressed satisfaction with domestic economic developments, he described the 1959 balance-of-payments result as "disappointing". This outcome was largely attributable to an 8 per cent increase in imports which, as the Chancellor said, was "a natural consequence . . . of the expansion in domestic activity" and which, one may add, undoubtedly contributed signifi-

cantly to the maintenance of price stability. Since exports expanded much less rapidly than imports and since net earnings from overseas operations of oil companies were reduced, the current account surplus in Britain's balance of payments dropped from £349 million in 1958 to £145 million in 1959 and actually changed to a small deficit in the final quarter of the year. Moreover, while Britain's current account surplus was declining, outflows of British capital increased. In large part this rise was nonrecurrent in character, some £232 million being paid on account of Britain's increased subscription to the International Monetary Fund and £89 million in repayment of its Export-Import Bank loan. In addition, however, British investment abroad and aid to Commonwealth countries remained at a high level, higher indeed (as the Chancellor said) than could be covered by the reduced surplus on current account. In consequence, Britain's gold and convertible currency reserves declined £119 million during 1959 while its overseas sterling liabilities rose £227 million. Mainly as the result of these changes, Britain's international monetary position deteriorated, taking into account both special and ordinary transactions, by £363 million or, excluding the special transactions, by about £100 million—a result that the Chancellor regarded as "most unwelcome".

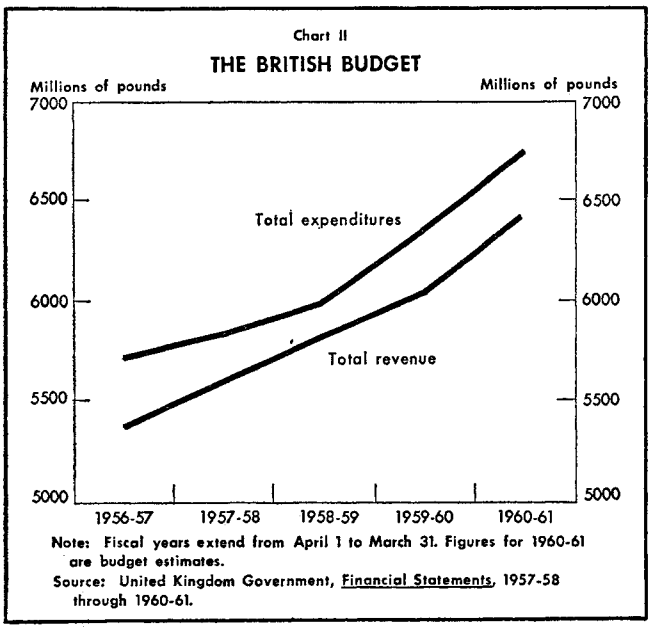
Assessing the prospects for the year ahead, the Chancellor foresaw a continuation of many of the past year's trends. Spending by the public authorities (including both central and local governments) would expand somewhat more rapidly than in 1959, while private investment would be substantially higher. On the other hand, inventory accumulation was likely to be reduced and a slowing-down in the rise of instalment credit might dampen the growth of personal consumption. As against this, the prospects were for a somewhat slower rate of increase in output than in 1959 because many of the industries on which demand is now being concentrated are working close to full capacity and because of spreading shortages of labor and even of certain materials. On balance, the Chancellor's judgment was that:

> the prospective increase in demand arising from the factors I have mentioned is likely at least fully to absorb, and might even involve a danger of outrunning, the increase in production which can be expected.

Against this background the Chancellor formulated the government's financial policies, his main concern being to preserve both domestic price stability and the strength of sterling as the underpinning for further expansion. In the monetary policy field, he noted that a growth in bank credit had been making a significant contribution to stimulating the economy but that "we have reached the stage where we should be cautious" about further credit expansion. Observing that the first steps in restraining private credit had already been taken through the 1 per cent increase in the Bank of England's discount rate to 5 per cent on January 21, 1960 and subsequently through open market operations, the Chancellor gave warning that additional steps would be taken, if necessary, to restrain the expansion of private credit. Such steps were in fact announced on April 28. Instalment credit controls, which had been removed in October 1958, were reimposed. Moreover, in a move to slow an expected rise in commercial bank liquidity and thereby to restrict the banks' capacity to expand credit, the Bank of England directed the London clearing banks to place with it, by June 15, special deposits equivalent to 1 per cent of each bank's gross deposits. A corresponding call of ½ per cent was made on the Scottish banks. This call for special deposits is the first under an arrangement announced in July 1958. The special deposits are to carry interest based on the going rate for Treasury bills but are not eligible for inclusion in the banks' minimum holdings of cash and other liquid assets.

In the field of fiscal policy, the Chancellor in his April 4 address indicated that budgetary expenditures were expected to total £6,730 million in the year that began April 1, 1960, £400 million higher than in the year before (see Chart II), mainly because of increased spending on defense, education, roads and on hospitals and other health services. On the other hand, even with taxes unchanged at their 1959-60 rates, the prospective rise in British economic activity was expected to bring an almost commensurate increase in revenue, so that the over-all budgetary deficit would increase only £17 million to £331 million.

However, since even such a modest rise in the deficit was inconsistent with the government's policy of moving toward financial restraint, the Chancellor proposed tax and other policy changes that would act to withdraw some purchasing power from the economy. Apart from various minor tax concessions and measures to eliminate inequities and plug loopholes, the Chancellor proposed two major tax changes: (1) a 5 per cent increase in the duty on tobacco and tobacco manufactures that was expected to raise revenue by £39 million during the current fiscal year, and (2) an increase to 12½ per cent from 10 per cent in the surtax on corporate profits, the existing standard rate on corporate income being left unchanged at 38.75 per cent. Although the increase in the profits tax was expected to raise revenue significantly only in 1961-



62 and thereafter, the Chancellor held that the increase would not "be without its influence on consumption and expenditure" in the current fiscal year, presumably because he expected that it would curb dividend payments and depress equity values. All told, the Chancellor's proposals aimed to reduce the over-all budgetary deficit to £318 million in 1960-61, only slightly higher than in the fiscal year just ended. In addition, the Chancellor proposed to offer more generous returns on the government's various small savings securities, net sales of which in 1959-60 had brought the Treasury an amount of new money almost equivalent to its over-all budgetary deficit.

In the course of his comments on the prospects for the British economy generally and for the budget in particular, the Chancellor alluded to the numerous uncertainties with which the government was faced in formulating its financial policies. There was the question whether the restraint on personal consumption that might be exerted by a slower rise in instalment credit would not be offset (given the tighter labor market conditions that now prevail) by accelerated increases in spendable income. Moreover, the Chancellor's own observation that ordinarily one would expect inventories to be "run down in the early stages of a recovery and to be rebuilt in the later stages" casts some doubt upon his estimate that inventory accumulation would be smaller this year than last. The Chancellor also noted a number of factors not taken into account in the budget estimates themselves. On the revenue side, no account was taken of any receipts that might accrue from the resale to the public of various iron and steel companies that are still to be denationalized. An underestimation of the rise in expenditures may be even more significant. No provision was made for the salary increases that are to be granted to doctors and dentists working under the health service. Moreover, although provision was made for the financing of the National Transport Commission's deficit, including the 5 per cent interim wage increase awarded to the railroad workers in February, none was made to cover the additional increases that are in prospect under the terms of the Guillebaud report on railroad workers' pay.

The government is clearly aware both of these uncertainties and, on a broader plane, of the relatively smaller shift toward restraint in its fiscal policy than in its monetary policy. Apparently it was this awareness that prompted both the Chancellor's warning of a further tightening of monetary policy and also the credit restraint measures that were announced toward the end of April. The Chancellor concluded his budget address to Parliament with the declaration that the government's financial policies would have "just that moderating influence on the rate of expansion that we need in existing circumstances". Britain, he concluded, would thus be able to "advance in the year ahead at a pace which will not endanger the stability upon which our whole prosperity depends".

EXCHANGE RATES

Activity in the New York foreign exchange market increased substantially during April. Spot sterling generally was strong during most of the month, owing mainly to commercial demand. About midmonth, however, and again toward the month end Continental selling of sterling caused temporary downward adjustments in the sterling quotation. Thus, after advancing to $2.8121 early in April—the highest since August 1959—the rate moved somewhat lower at midmonth. Thereafter, the quotation partially recovered but on April 26, under substantial pressure, dropped to $2.8073, the low for the month. On April 29 spot sterling was quoted at $2.8091.

In the forward market, the discounts on three and six months' sterling widened appreciably early in the month, reaching 71 and 99 points, respectively, on April 8, the largest spreads since November 1958. A subsequent contraction in the spreads, continuing to midmonth, was later offset, the discounts moving to 61 and 98 points at the month end.

The rate for the Canadian dollar, reflecting substantial commercial demand for United States dollars in Canada, declined from $1.04 21/32 at the beginning of April to

$1.03 27/64 on April 11—the lowest quotation in a year. Thereafter, although moving somewhat erratically, the rate advanced to $1.03⅝ on April 29.

The Swedish krona, reportedly reflecting the repatriation of foreign assets by Swedish nationals, advanced from $0.1933¼ at the beginning of the month to $0.1940¼ by April 19, then eased slightly. Most other European currencies were steady and firm against the dollar.

United States Cotton Export Program

The substantial contribution of increased exports of raw cotton to the recent rise of total merchandise exports has drawn attention to this country's cotton export program. In the seven months from August 1959—when the current marketing year for raw cotton began—through February 1960, total United States exports excluding military-aid goods were $790 million higher than in the corresponding period a year earlier, and $270 million of this increase was accounted for by larger shipments of raw cotton.

The sharp recovery in raw cotton exports—representing a doubling as compared with the depressed level of the first half of the 1958-59 marketing year—was stimulated by lower domestic prices and by the rise in the export subsidy for the current marketing year. Without the subsidy, United States producers of cotton would be unable to compete in international markets because the Government's price support program keeps the domestic prices of raw cotton above current world prices. Whenever world cotton prices are below the Government-supported domestic price "floor", United States exporters are unable to compete unaided in international markets. As world cotton prices declined sharply in 1955-56 and again in 1958-59, our exports were undersold by foreign growths, and consequently cotton exports were exceptionally low in both these periods.

To offset these price differentials, the Commodity Credit Corporation (CCC) began, effective August 1, 1956,[1] to subsidize cotton exports, using the "competitive-sales" method. Under that program, which was used in the marketing years 1957 and 1958, the CCC auctioned cotton to exporters from its own stocks, accepting bids that fell short of the United States spot prices by around 6 to 8 cents per pound. In 1958-59, that method was supplemented by the "payment-in-kind" method, which is the only one in effect during the current marketing year. Under this new program the exporters purchase cotton on the open market and register their export sales with the CCC. They are then issued cotton export payment certificates which can be redeemed by withdrawing from CCC stocks an amount of cotton equivalent in value to the subsidy to which they are entitled. This year's subsidy rate is 8 cents per pound, compared with 6.5 cents in 1958-59.

Subsidy payments are also granted on Government-financed cotton exports under the Agricultural Trade Development and Assistance Act of 1954 (Public Law 480) and Section 402 of the Mutual Security Act. Under P.L. 480, surplus agricultural products are sold for foreign currencies (which are mainly loaned back to the purchasing country), bartered for strategic materials, or given as outright grants. In addition, Section 402 of the Mutual Security Act requires that at least $175 million of our foreign-aid appropriations be extended in the form of farm products; these are either directly granted or sold abroad for local currencies that are then used for the purposes of the act. Cotton exports under these two programs averaged two fifths of our total cotton shipments during the fiscal years 1956-57 to 1958-59.

Because United States manufacturers must purchase raw cotton at domestically supported prices while their foreign competitors can obtain United States cotton at the lower, subsidized prices, the CCC also initiated in August 1956 its Cotton Products Export Program. By registering with the CCC their foreign sales of cotton products, the exporters receive an "equalization payment" so calculated as to offset fully the cost differential due to the raw cotton export subsidy; contrary to the latter subsidy, which is paid in kind, the equalization payment is in cash. Under this program, cotton products are classified into fourteen export categories, the equalization payment rate varying with their raw cotton content.

Although the Cotton Products Export Program offsets, on the export side, the price handicap of United States textile manufacturers who cannot purchase the subsidized cotton available to their foreign competitors, no corresponding equalization has been attempted in the case of imported cotton products sold in competition with do-

[1] Earlier, in January and February 1956, the CCC had sold for export at reduced prices one million bales of short staple cotton. A number of programs for subsidizing cotton exports had been employed in the 1940's.

mestic goods in the United States market. However, at recent hearings of the Tariff Commission the Administration proposed the imposition of an "import fee" on cotton textile manufactures, to cancel out the effect of the cheaper raw cotton available to foreign producers.

Revising upward the forecasts of an excellent crop it made last fall, the Department of Agriculture now expects our raw cotton exports in the current marketing year to reach 6.5 million bales, more than twice last year's 2.8 million bales and second only to the postwar record of 7.6 million bales exported in the marketing year 1956-57. Both export sales registrations with the CCC and actual cotton shipments to date seem to confirm this new forecast. Indeed, reversing the depressed trend of the previous two years, foreign demand is now soaring, under the impact of a boom in textile production abroad and the necessity of replenishing inventories that had been drawn down partly in anticipation of the rise in the United States export subsidy. The raw cotton production of our foreign competitors, on the other hand, has fallen off for the first time in a number of years, partly because of acreage reductions abroad in anticipation of this year's more competitive United States export prices. United States cotton exports are reacting so strongly to this improved world situation because exporters are able to quote much lower prices to foreign purchasers than last year. Apart from the 1.5 cent per pound subsidy increase mentioned above, there has also been a significant reduction in domestic prices, made possible by a lowering of the support prices and of the CCC's minimum domestic sales prices.

The Department of Agriculture has announced that support prices and minimum domestic sales prices will be further reduced in the 1960-61 marketing year. By next August 1, this will permit the reduction by 2 cents, to 6 cents per pound, in the raw cotton export subsidy and yet leave the competitiveness of United States cotton on world markets substantially unchanged. The subsidy will continue to be granted under the payment-in-kind method. The Cotton Products Export Program has also been renewed for 1960-61, but the equalization payment rate will be reduced by 25 per cent because of the lower export subsidy.