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New York State's "Omnibus Banking Law"

Significant changes in New York State's banking structure have been made possible by the so-called "Omnibus Banking Law" enacted on March 22, 1960. The new law, which takes effect July 1, 1960, marks the first major revision in New York State law relating to banking structure since 1934 when the State was first partitioned into nine banking districts.

This article is intended to provide readers with background information on the new law; to set forth some of the issues leading up to its enactment; and to consider generally the statutory standards which, for the first time, must be applied by the State bank supervisory authorities in passing upon bank mergers and the operations of bank holding companies.

THE MAJOR PROVISIONS

The new law has as its purpose the furthering of orderly development of banking within New York State in response to economic changes that have occurred since World War II. At the outset, the law declares State policy to include the prevention of "statewide control of banking by a few giant institutions" and the fostering of "healthy and non-destructive competition . . . among all types of banking organizations within natural economic and trade areas". At the same time, however, the law grants certain new branching and merger privileges to commercial banks in New York City, Nassau, and Westchester Counties,¹ and authorizes the formation and regulation of bank holding companies within the State.

Briefly, the principal provisions of the new law are as follows:

(1) Subject to approval by the appropriate bank supervisory authorities, New York City commercial banks are permitted to operate branch offices outside that city in the two suburban counties of Nassau and Westchester. Commercial banks in those counties are likewise allowed to operate branches within the five boroughs of New York City. Also, subject to such approval, interdistrict mergers are permitted between New York City and Nassau or Westchester commercial banks. With these exceptions, any branch system must remain within one of the nine banking districts established in 1934.

¹ Savings banks, State-chartered savings and loan associations, and industrial banks are also accorded wider branching privileges. Much of the controversy prior to passage of the Omnibus Law involved the future role of savings institutions in relation to commercial banks. These aspects are not treated in any detail in this account, which concentrates on developments relating to commercial banking.

(2) For the first time, mergers and purchases of assets must now meet express statutory standards.

(3) The "freeze" on the formation of bank holding companies or their expansion across district lines in effect since 1957 is terminated as of June 30, 1960. The formation of new, and the expansion of existing, bank holding companies within the State are again permitted, but are now subject to regulation by the bank supervisory authorities.

Under the new law, then, commercial banks located in New York City may expand, subject to the approval of the State bank supervisory authorities, across district lines by any of three means: they may establish branches within Nassau or Westchester Counties; they may merge with banks in those counties; or they may affiliate with an existing bank holding company or participate in forming a new bank holding company. Similarly, Nassau or Westchester commercial banks may expand into New York City by the same methods. Although the branching and merger privileges of commercial banks located elsewhere in the State are not changed by the new law, such banks may form or participate in bank holding companies.

Approval of the provisions briefly summarized above climaxed a number of years of effort on the part of the State Legislature. Complete re-study of New York State's banking law was authorized in 1955, for the purpose of revising the law in the light of changes that had occurred since the last major revision. The creation of a Joint Legislative Committee for Revision of the Banking Law followed quickly, setting the stage for the subsequent years of study and debate.

The committee was confronted almost at the outset with issues going beyond merely technical amendments: broadly, the need to strike a balance between one set of views favoring the widening of branching powers and another concerned primarily with protecting the smaller community-type organization. The committee was also faced with the conflicting interests of commercial banks and savings institutions in the competition for savings accounts. Until this year, however, neither the committee nor the Legislature seemed able to resolve the underlying issues. The only step taken was hurriedly to enact in 1957 the now-expiring "freeze" on bank holding companies, when it appeared that far-reaching changes in New York's banking structure might occur before the committee's investigations were completed and new legislation enacted.

Opinion concerning the new law is by no means all

favorable. While some New York City bankers hail the Legislature's action as a constructive step in developing the economy of the city and State, a number of Nassau and Westchester leaders have voiced fears of the consequences of large New York City commercial banks branching into their counties. The issues involved may perhaps be better understood when the new law is viewed against a broader historical perspective of the evolution of the structure and regulation of banking in New York State.

HISTORICAL BACKGROUND

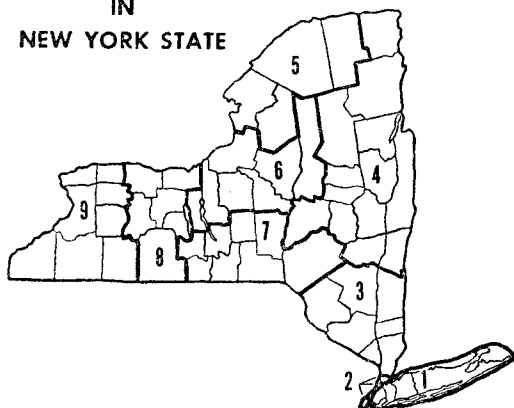
In a sense, the current debate had its beginnings at least twenty-five years ago in 1934 when the State Legislature made the first important breach of a century-old tradition against branch banking in New York State. From 1836, when the charter of the Second Bank of the United States expired, to almost the turn of the century there had been little or no branch banking in the State. In 1898 branch banking was permitted within New York City, and in 1919 this was extended to cities with over 50,000 population, but neither of these actions permitted a bank to establish branches outside its home community. In 1934, however, the Legislature voted to partition New York State into nine banking districts (see map) within each of which commercial banks might establish branches so long as the branch was not established in a city or village in which the head office of another bank was already located. Branch banking within New York City continued to be permitted, even though its counties are split between two districts.

The division of the State into nine banking districts for branching purposes was part of a great widening of branch privileges that took place in many parts of the country during the twenties and early thirties. In New York State, as elsewhere during the Great Depression, bank failures had been most numerous among the smaller sized independent banks upon which local business credit largely depended. The pattern of failures revealed, among other shortcomings, a frequent lack of loan diversification in the home community that reflected the limited variety of local credit demands. Moreover, bank failures had left a great many communities without any banking facilities, while many other small communities had always been bankless simply because local citizens could not raise sufficient capital to organize an independent bank.

It was agreed that branch systems, through diversification, might more easily withstand the shock of general economic downswings; might produce new facilities to replace those destroyed in the banking crisis; and might bring banking offices to localities where they had heretofore been lacking. Governor Lehman summed up the majority sentiment of the time in his memorandum of May 21, 1934 approving the district line law of 1934. He wrote that

This bill is the only means open to the people and commercial business interests of these communities to obtain banking facilities. Many of them are in dire need of banking facilities. The lack of them has not only inconvenienced the people, but has handicapped the tradesmen and businessmen of these communities. In large

BANKING DISTRICTS IN NEW YORK STATE



Counties in each banking district:

1. Kings, Queens, Nassau, and Suffolk.
2. Richmond, New York, and Bronx.
3. Westchester, Rockland, Putnam, Dutchess, Orange, Ulster, and Sullivan.
4. Columbia, Rensselaer, Washington, Greene, Albany, Schenectady, Saratoga, Warren, Essex, Schoharie, Montgomery, Fulton, Hamilton, Otsego, and Clinton.
5. Jefferson, Lewis, Saint Lawrence, and Franklin.
6. Herkimer, Madison, Oneida, Onondaga, Oswego, Cayuga, and Seneca.
7. Chemung, Schuyler, Tioga, Tompkins, Broome, Delaware, Cortland, and Chenango.
8. Monroe, Wayne, Livingston, Ontario, Yates, and Steuben.
9. Chautauqua, Cattaraugus, Allegany, Erie, Niagara, Wyoming, Genesee, and Orleans.

measure all the activities of those communities have been seriously curtailed.

He added, however, that the new branch law would not "permit the unjustified establishment of numerous branches nor . . . unnecessary competition. . . . This bill should in no way injure the sound unit banks in this State." In fact, the law represented a compromise between extreme viewpoints, one favoring State-wide branch banking, the other strongly opposing any action that might lead to the concentration of power in big city banks at the expense of independent unit banking.

STATE-WIDE DEVELOPMENTS SUBSEQUENT TO 1934

After the passage of the 1934 district line law, the role of independent local banks in New York State began to diminish. Regional branch banking grew and spread within each of the banking districts of the State. New York was not unique in this respect. The same results were found wherever State laws permitted branch banking. The number of commercial banks in the United States was declining slowly but steadily even before the well-publicized "merger movement" after World War II.

Postwar developments in New York State's economy, particularly the shift of population and business from the central cities toward the neighboring suburbs, tended to accelerate tendencies already in evidence before World War II. Institutions that had previously emphasized "wholesale banking", servicing primarily the needs of large business borrowers, turned more toward consumer lending and other forms of "retail banking". Banks competed vigorously for savings deposits, as retail banking became more profitable and deposits harder to get relative to lending opportunities.

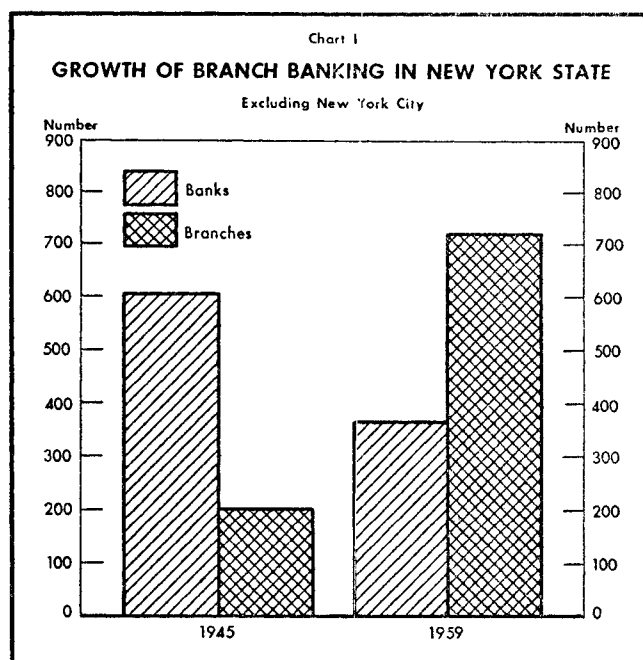
It was this desire to expand retail banking operations, in particular, that induced banks to open new branches wherever possible or to absorb other institutions. At the same time, commercial banks also tried to increase their capital resources through merger. Since, in most cases, a commercial bank may not make loans to a single borrower in excess of 10 per cent of its capital accounts, the increase in the capital accounts generally resulting from mergers helped banks to accommodate the expanding credit needs of their larger business customers who were experiencing sizable growth during the generally prosperous postwar period.

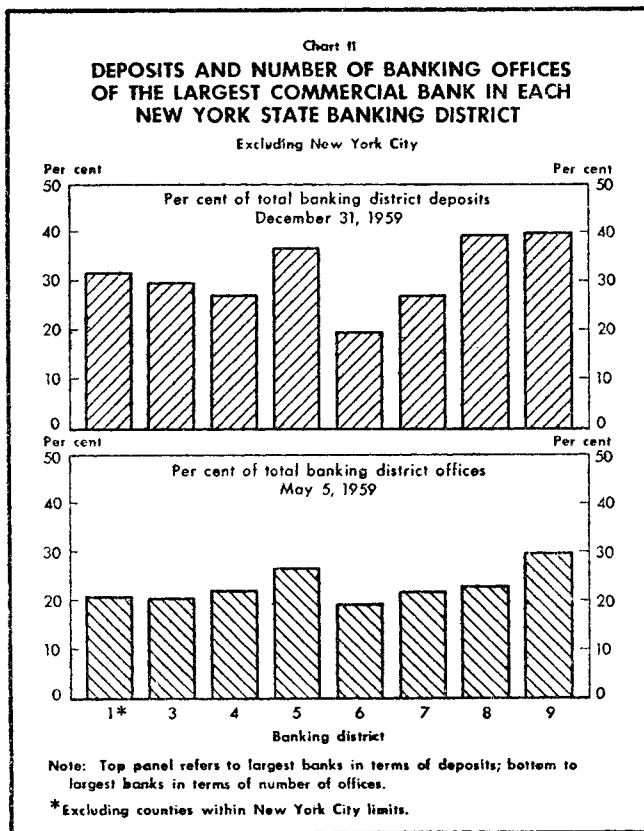
The pattern of banking outside New York City rapidly assumed the shape of district-wide branch banking, mainly involving a handful of large banks whose head offices were in the largest cities of New York State. The number of branch banks more than doubled from 56 in 1945 to 121

in 1959, and their total number of offices more than tripled. In 1959, branch banks controlled well over 75 per cent of total bank assets outside New York City, contrasted with 55 per cent at the end of World War II. Of course, branch banks vary widely in size, and not all of them are "giants". But New York State (outside New York City) in 1945 had only 5 banks with 10 or more branches each—all of them in Buffalo and Rochester. By 1959 there were 21 such banks. Hence, certain objectives of district line legislation designed to protect and preserve unit banking were realized only in part. The number of independent community banks operating within the State declined substantially, their remaining strongholds narrowing to the smaller towns. Between the close of World War II and the beginning of 1960, the number of commercial banks in the State outside New York City declined from 603 to 360. During the same period, the number of branch offices increased from 197 to 723 (see Chart I). Some idea of deposit and banking concentration within the various banking districts of the State can be obtained from Chart II.

Attracting little public attention until a few years ago, was an allied development in group banking—the growth and spread of the bank holding company.² These companies had not been regulated by the 1934 law. Indeed,

² Bank holding companies are sometimes referred to as "group banks". Both names refer to a situation in which a number of separately incorporated banks are controlled by a corporate holding company.





with the exception of the past three years during which the bank holding company "freeze" law has been in effect, holding companies have been free to operate on a State-wide basis. Thus, during approximately the same period in which the rise of branch banking occurred, New York became the leading bank holding company State in the nation measured by affiliated offices—192, comprised of 21 banks and 171 branches. While the Marine Midland Corporation has held the limelight, other group banks have also been developing in the State. Under the definitions established in the Federal law (The Bank Holding Company Act of 1956), there are now 9 holding companies operating within the State, of which 5 are New York companies and the remaining 4 are out-of-State companies.

DEVELOPMENTS IN THE NEW YORK METROPOLITAN AREA

The transformation in banking structure took place in all banking districts throughout the State. But nowhere have postwar changes aroused greater interest than in the

counties immediately adjoining New York City. It is these areas that are chiefly affected by the new legislation.

Nassau County furnishes an outstanding example. Shortly before World War II the county was served almost wholly by independent unit banks. There were only 4 banks whose deposits exceeded \$5 million, and their combined deposits accounted for only 19 per cent of the county's total. The largest bank at the time had but \$6.5 million in deposits; 29 of the 53 commercial banks had deposits of less than \$2 million, and 9, of less than \$1 million. The war brought many changes, but not even by 1947 had the metamorphosis of the county proceeded very far. The next decade, however, witnessed the sweeping changes that transformed the structure of Nassau banking from one comprised almost exclusively of community banks to one consisting of a few large banks with numerous branches throughout the county. Recent data show only 7 of Nassau's communities served solely by a local bank (including its branches within the community); 9 other communities served by both head offices and one or more branches of other banks existing side by side; and 58 served solely by branch offices of banks with head offices elsewhere.

The trends exhibited in Nassau have been generally characteristic of Westchester County as well. It merits emphasis, however, that postwar changes in banking structure in Nassau and Westchester Counties only paralleled those already noted within other banking districts throughout upstate New York—as well as within New York City itself.

NEW YORK CITY VS. THE SUBURBS

One major difference characterized the developments downstate. Banks in the major upstate cities had been able to expand along with their metropolitan areas. There were slight declines in the number of commercial banking offices within the six largest upstate cities (as a group) during the first postwar decade—but new branch openings in the outlying areas more than offset this, and indeed rapidly outpaced the rate of population growth.

New York City banks, however, were barred by law from duplicating the upstate pattern. The 1934 law had deliberately restricted these banks to branches within the City of New York. The Governor's signing message had highlighted the "solid, strong safeguards" written into the law, stating that "the banks in Manhattan are given no power additional to that which they possess to open branch banks". The provision reflected the widely held fears that the large New York City banks would come to dominate the entire commercial banking system of New York State if not severely restricted.

This limitation began to loom more significantly in the postwar years. A number of New York City banks felt that, despite their unique advantages and proven ability to attract nation-wide customers, the long-term prospects facing them were unpromising. The financial center's share in nation-wide bank deposits has been declining. From the outset of World War II through the end of 1959, deposits of all commercial banks tripled, increasing from approximately \$71 billion to \$216 billion. By contrast, deposits of the large downtown banks of New York City expanded only 67 per cent, from \$18 billion to \$30 billion, and most of this increase occurred during the war. As a corollary of the disparate rates of expansion, the share of the New York central reserve city banks in the deposits of all commercial banks declined from 25.4 per cent to 13.9 per cent between 1941 and 1959. The virtual absence of any growth of deposits at the City banks in the postwar period has raised doubts concerning the long-run ability of the New York City banks to keep pace with the rising credit needs of their traditional customers, the nation's largest corporations.

Many New York City institutions felt that there were compelling reasons to regard the adjoining suburban counties as part of an integrated metropolitan region rather than as self-contained regions detached from their central city. In this view, New York City was seen as the nucleus of a trade area similar to the regions comprising upstate banking districts. But on the opposite side of the fence, suburban banks were equally vocal in rejecting economic integration with New York City—and pointed to local industry and employment that were making the suburban counties increasingly self-sufficient. There were also frequent appeals to the Legislature's basic policy that community banking in the State be protected from onslaughts of New York City "giants".

The Legislature decided the outcome in March of this year, thereby breaking the long-standing deadlock between the New York City and suburban bankers.

THE NEW LAW AND BANK SUPERVISION

There are a number of safeguards written into the new law to protect existing institutions and the public. Statutory standards covering both banking and competitive factors, as well as the public interest, must be considered by the State bank supervisory authorities in approving or disapproving bank mergers and bank holding company operations. While there has been no change as to the requirements for approval by the State bank supervisory authorities of branch establishments, it should be remembered that such establishments have always required a

showing that the public convenience and advantage would be promoted.

During the three-month interval elapsing between the date of enactment and the effective date of July 1, 1960, both bankers and supervisory authorities have been studying the alternatives and considering the outcome of action under the new law. Despite suburban opposition to their expansion plans, some New York City banks appear certain to attempt to obtain the benefit of the new provisions.

BANK MERGERS. Of the issues raised, perhaps none have proved more difficult in the past than bank mergers. The new law for the first time gives explicit recognition to the risks of overconcentration that may arise out of banking consolidations. Heretofore, New York State's banking law was explicit only in its general statement of policy to guard against "unsound and destructive competition . . . and thus to maintain public confidence". Now the law includes explicit statutory standards which must be taken into account by the State bank supervisory authorities. In passing upon bank mergers, the authorities must consider:

- (1) The new declaration of policy, including the statement that "competitive as well as banking factors be applied by supervisory authorities in approving or disapproving bank mergers";
- (2) Whether the effect of the proposed action will result in the expansion of the size or extent of the resulting bank beyond limits consistent with adequate or sound banking; or in a concentration of assets beyond limits consistent with effective competition;
- (3) Whether the proposed action may result in such lessening of competition as to be injurious to the interest of the public or tend toward monopoly; and
- (4) The public interest.

It is a commonplace that banking factors and competitive standards, both of which seem desirable on the surface, are not always easy to reconcile. The Board of Governors of the Federal Reserve System has had to cope with these and similar issues in the past in passing on applications before it. Indeed, the Board has been guided by standards extending beyond the so-called "banking factors" and has adhered to the spirit and intent of the anti-trust laws even when not required to do so by any literal interpretation of the applicable banking statutes. Moreover, the Board of Governors' role has recently been considerably expanded by the enactment on May 13, 1960 of the Federal bank merger law (P.L. 86-463, 86th Cong.).

This law requires Federal approval of every merger or consolidation of insured banks. In acting upon mergers covered by this law, the appropriate Federal bank super-

visory authority is required to consider specified banking factors and, in addition, "the effect of the transaction on competition (including any tendency toward monopoly)", and cannot approve any transaction, unless, after consideration of all the factors, the transaction is found to be in the public interest. Despite differences in the language of the New York and Federal statutory standards, it is clear that under both laws the competitive aspects of a proposed merger will be an important consideration.

In practice, the State and Federal bank supervisory authorities have in the past considered such factors in connection with merger proposals. The new State and Federal laws now make consideration of such standards mandatory.

BANK HOLDING COMPANIES. July 1, 1960 is also a significant date for bank holding companies in New York State. At that time, the "freeze" law having terminated, the situation existing before 1957 is restored, but subject to restraints written into the new legislation. The major distinction between the new circumstances and those antedating the "freeze" lies in those sections of the Omnibus Banking Law which, for the first time, make bank holding company operations subject to State regulation and establish standards for the State to consider in determining whether or not to approve an application for bank holding company formation or expansion.

In acting on these applications, the State banking supervisory authorities are required to consider substantially the same standards as those established for bank mergers under the State law set out above. Essentially, these standards conform, with certain exceptions, to those set forth in the Federal Bank Holding Company Act of 1956 and repeated in the Board of Governors' Regulation Y. Under both Federal and State law, major emphasis in the bank holding company field—as in the merger field—is placed upon the fostering of competition and prevention of monopolistic control.

Removal of the "freeze" may encourage some banks to affiliate with existing holding companies or to join in establishing new ones. The major advantages and drawbacks of the holding company form of organization, from

the institutions' standpoint, are quite familiar. Weighed against certain tax disadvantages, for example, are the broad gains of sharing in the benefits of large-scale banking while retaining individual corporate existence.

Holding companies in New York State are subject to both the Federal and State laws. The Federal Bank Holding Company Act of 1956 authorizes the formation of bank holding companies and vests responsibility for the act's administration in the Board of Governors. The act lists five factors that the Board must consider before granting an application to establish or expand a bank holding company:

- (1) The financial history and condition of the applicant and the bank or banks concerned;
- (2) The prospects of the applicant and the bank or banks concerned;
- (3) The character of the management of the applicant and the bank or banks concerned;
- (4) The convenience, needs, and welfare of the communities and the area concerned; and
- (5) Whether or not the effect of the proposed transaction for which approval is desired would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking.

Of the five factors cited above, the last was attributed the greatest weight by the Board in denying the only application for the formation of a new bank holding company thus far considered in New York State under the Federal act—the affiliation of the County Trust Company of White Plains and the First National City Bank of New York under the proposed First New York Corporation.

The standards considered here will have a major role to play in future applications now that New York State law once more permits holding company formation and expansion. The various supervisory agencies concerned have the task of establishing a body of regulatory practice that will conform to the principles established in Federal and the new State legislation.

A Breathing Spell for Monetary Policy*

By **ALFRED HAYES**

President, Federal Reserve Bank of New York

When I spoke to you two years ago, the nation's economy was just starting to emerge from a brief but relatively sharp recession. The paramount task facing monetary policy accordingly was to assist in every way to bring about a speedy and sound recovery. As the recovery proceeded—far more swiftly in most respects than had seemed likely at the outset—the appropriate role of monetary policy quickly shifted from one of active stimulation of credit growth to moderate and then rather firm restraint. This was designed to hold the credit formation associated with the expansion of business activity within sustainable bounds, avoiding the inflationary bursts that are, no less than recessions, the inveterate enemies of real growth. Even when the economy's advance was interrupted by last summer's steel strike, there were widespread expectations that settlement of the strike would launch a powerful new burst of expansion, attended by renewed inflationary pressures, and this meant that a rather taut rein had to be maintained on bank credit expansion even through the period of the shutdown.

Let me add immediately that this relatively taut rein did not mean that credit expansion was held to small proportions. The total expansion of credit of all types in 1959 was at a peacetime record of \$62 billion, and the only sense in which this was small was in comparison with the even larger rise that would have occurred had all demands for funds been met—no doubt with severe inflationary consequences. I would point out, too, that some of those sectors of the economy that are often singled out as faring relatively badly at the hands of restrictive monetary policy came out rather well. Some \$19 billion of the \$62 billion total went into residential and other mortgages, a towering increase that eclipsed the previous record by nearly one fifth. State and local government debt, including provision for schools, increased by a near-record \$5 billion. And at the same time the Federal Government had to finance a cash deficit of about \$8 billion during the calendar year. The sharp rise in interest rates during 1959 was the dramatic result of the strength of these and other credit demands (including, incidentally, a rise of more than \$6 billion in consumer credit).

* An address before the Fifty-seventh Annual Convention of the New Jersey Bankers Association, Atlantic City, New Jersey, May 19, 1960.

In the past several months, for reasons that I want to discuss further in a moment, some of these exceptional pressures on the financial markets have abated. Interest rates have receded from the thirty-year high levels reached in late 1959 and early 1960, along with a tempering of overexuberant business expectations and an apparent substantial lessening of prevalent expectations of inflation. The downward adjustment in stock market prices has been another manifestation of the psychological turnaround.

This change in atmosphere has been based on a number of factors. One is that recent business developments, while indicative of well-sustained strength in the economy, have lacked the boomy quality that many had rather automatically associated with the resumption of steel production and, perhaps, with the onset of the "soaring sixties". This is not at all to say that we are in a slack period; the gross national product rose to a record annual rate of \$500 billion in the first quarter of this year, while personal income and employment also set new records (after seasonal adjustment). While unemployment continues to be a problem, recent surveys indicate that business outlays for new plant and equipment will be markedly higher this year than last. In essence, however, what has happened is that the special stimulus provided by the end of the strike has been shorter lived than some had expected; steel needs have been filled quickly and the pace of total inventory accumulation has abated, with widespread effects on new orders and sales; but, over all, demand remains strong.

Another reason for the recent change in the financial atmosphere—and it is a highly gratifying one—is that the price level has been essentially stable for some time. Average wholesale prices have barely changed in two years (though there have been some offsetting movements among major components along with seasonal swings), and average consumer prices have been virtually steady for about the past seven months. Without making immodestly large claims on behalf of monetary policy, I believe that some of the credit for this good performance belongs to the timely application of monetary restraint in the earlier phases of expansion. Of great help, too, has been the much keener recognition on the part of both industry and labor of the dangers of inflation and the value of reasonably stable prices, not only because of their immediate

interest in expanding output, employment, and incomes, but also because of the broader need in the national interest to meet the challenge of ever more effective foreign competition. Whatever may be the ultimate results of the steel settlement reached in the first few days of this year, it has at least not been followed promptly by price boosts, or by large pay increases in other industries—as had been the past pattern. And some credit for domestic price stability must, of course, also be given to the generally ample supply of most international commodities.

Still another force contributing to the changed atmosphere of recent months—and this one has had decisive effects on the financial markets—has been the changing Federal cash position. For years, monetary policy has had to carry much the greater part of the burden that fiscal and monetary policy should share. As a result, the effects of needed restraint have been sterner for the economy as a whole than would otherwise have been necessary. Federal cash surpluses were too small, or nonexistent, or were instead transformed into deficits, at times when restraint on aggregate demand was called for. Clearly, the massive shift from a \$13 billion cash deficit in the fiscal year 1959 to a position of approximate balance in the fiscal year now drawing to a close has exerted a major influence upon the relation between the supply and demand for funds, particularly in these current months when the concentrated effects of a seasonal cash surplus are being felt. A fiscal policy that proved to be flexible only in providing deficits at times of recession would clearly be out of step with the realities of the modern American economy. Equally necessary are the surpluses in relatively prosperous times that can ease the pressure on capital markets and supply resources to support real growth at home and elsewhere in the world.

Taken together, these changes in market atmosphere and the related underlying developments in the domestic economy—along with the recent moderate improvement in our international payments position—have provided something of a breathing spell for monetary policy. It has thus been possible to relax somewhat the degree of monetary restraint which had been maintained in the second half of 1959. While the central bank can never allow the problems of coping with potential boom or recession to recede very far into the background, this more relaxed setting gives us a valuable opportunity for focusing on some of the longer range problems that are facing our monetary system. Indeed, it is only by giving close attention to these questions that we can hope to fashion the kind of flexible monetary policy that is required in a continuously changing economy. Many of these problems have been, and are being, subjected to close

scrutiny from such quarters as the Joint Economic Committee of Congress and the Commission on Money and Credit—and this is most welcome, although, of course, it is no substitute for continuous appraisal by the rest of us as well. Naturally, I cannot hope to do more than touch on a few of these problems. The implications of an apparent tendency toward increasing structural (or, if you will, “technological”) unemployment disturb me considerably, for example, but I will not try here to make even a beginning toward the searching study which that key problem deserves. Nor will I go into the question of consumer credit, and the need I sense for a new approach in methods of regulation if stand-by legislation should at some time be considered. Instead, but really only by way of illustrating the range of questions that deserve attention, I shall discuss some aspects of the issues that arise in relating the money supply to economic growth, in influencing the liquidity of the banks and others, in providing greater scope for flexibility of some of our more rigid interest rates—while noting the unusual volatility of some of our market rates—and in relating our domestic monetary policies to the international financial position of the United States.

One matter of obvious concern for the long run is the relationship between the money supply and the nation's economic growth. It is sometimes suggested that our obligation toward fostering growth could be fulfilled by mechanically augmenting the money supply in line with the long-term average increment in the nation's output—say, by 3 or 4 per cent each year. But adherence to such a rigid formula would mean foregoing all the advantages that flexible monetary policy can have in coping with actual or anticipated swings in economic activity. To illustrate: during 1958 and 1959 taken together, the money supply increased about 5 per cent, but four fifths of this increase took place in 1958. Now surely it was more appropriate that the money supply grew by 4 per cent in 1958, when expansion was needed to foster recovery, and by just 1 per cent in 1959 when restraint was called for, than that each year's increment be fixed at a constant figure.

A policy of invariant addition to the money supply, year after year, would also mean ignoring significant changes in habits of spending and holding liquid assets throughout the economy. These changes in liquidity and velocity can sometimes be just as important as movements in the money supply itself, in determining the course of financial markets. The expansion of other savings institutions apart from the commercial banks, the growth of the Federal funds market, and the increasing tendency of corporate treasurers to invest temporarily idle

funds in money market instruments may all be cited as striking examples of how the supply of bank reserves and deposits can be economized in a dynamic economy, bringing about significant increases in the velocity of circulation of the money supply. Recently there has been considerable evidence, in the form of higher velocity, that the economy has come a long way toward "growing up" to the larger money supply created during the recession of 1957-58—and indeed, from a longer perspective, to the excessive money supply created during World War II.

The question of just how high the velocity of money can go is an intriguing one theoretically, but of more immediate practical concern is the process by which velocity increases are brought about, and the effects of this process on financial markets. For while the efficacy of monetary policy has sometimes been challenged on the ground that increases in velocity can nullify efforts to achieve credit restraint, many of these critics fail to take into account that a rise in velocity may entail a simultaneous shift or reduction in liquidity which can have quite potent restraining effects. In the Federal Reserve we try, of course, to appraise just what those effects are, in the changing circumstances of each new situation.

Nowhere in the financial system is this impact of changing liquidity demonstrated more dramatically than in the case of the commercial banks themselves. At a time of strong business expansion, when reserve positions are under pressure and the release of new reserves by the monetary authorities is limited, the banks either meet loan demands by disposing of relatively liquid investments, or, reluctantly, they turn down some part of their customers' requests for additional credit, and often they do both. In the process, their liquidity positions come under increasing strain. Thus, in the recent cyclical experience we have seen the ratio of loans to deposits for all member banks rise from about 50 per cent in the summer of 1958 to about 58 per cent in recent months, and in the money market banks in New York from 57 per cent to 69 per cent.

In making this sizable shift in the distribution of their earning assets, the banks have inevitably found themselves holding back some of the expansion of loans that might otherwise have fed an inflationary burst of spending—thereby helping materially to bring effective monetary restraint into play during the expansion phase of the past two years. Theirs has been a hard role, but an essential one, and generally well performed. In one sense, it is true, they have had little choice, because of the Federal Reserve's control over total reserve availability, but their strong and understanding support has made the task of the monetary authorities much easier.

At some point, banks and their customers quite naturally feel a bit uneasy with their high loan-deposit ratios, raising a question as to whether the banks can contribute their share toward needed further growth of the economy. This is especially so where heavy loan holdings are coupled with bond portfolios that are frozen in by declines in capital values. The Federal Reserve is not at all unmindful of this concern, even though we do in fact rely upon the "loaned-up feeling" to help limit further bank credit expansion at times over the business cycle. I think it is just inherent in the nature of commercial banking that its over-all growth, so far as demand deposits are concerned, must be irregular. That is because the actual process of creating new money has, in itself, a stimulating influence—an influence that should be maximized by using more of it in periods when other forms of credit expansion are lagging, and when the economy may be in recession. Instead of merely creating money to service the transactions mechanics of a growing economy, the monetary system must utilize the full potential of the money-creating process to help bring about the conditions of economic stability upon which lasting growth depends.

Another aspect of the liquidity question to which we have been giving attention is the relatively sharp growth of term loans in recent years. For the large New York City banks, for example, this growth has reached the point where term loans account for more than half of the outstanding volume of all business loans. In itself, this is not necessarily questionable, and in fact the development of the term loan in the past quarter century has undoubtedly filled a very real need in the field of corporate finance; but I do believe we should avoid a situation in which banks become so heavily committed in the form of longer term advances that they cannot adequately meet legitimate short-term needs for which commercial banking characteristically provides rather unique facilities. Of particular concern to me is the tendency, during a period of restraint, for large corporations to defer public capital offerings and to finance their expansion programs instead through longer term bank loans. When the banks take on large amounts of such longer term loans, they may find that they have less opportunity to meet the short-term needs of smaller borrowers who have fewer open alternatives for raising funds. Another related factor that deserves more attention in the composition of bank loan portfolios is the eligibility of loans for rediscounting with the Federal Reserve. Now that some banks are close to the point at which borrowing from the Reserve Bank might have to take the form of advances on commercial paper, this question of eligibility has become one of practical significance.

In short, I am suggesting that there must be some happy mean between the outmoded and purist concept of confining bank lending to "self-liquidating", "commercial" loans, and the development of an unduly frozen position in longer term advances. Perhaps, in locating and maintaining that happy mean, some thought should be given to the possibility of setting different rates of interest on loans of similar quality, on the basis of differences in maturity or eligibility. For example, a higher rate on term loans might help to channel such borrowing into the long-term capital market. The variations in rate would not have to be large, and at times they might narrow down to the vanishing point, but just the possibility of such variations might add a useful dimension of flexibility to the setting of credit terms.

Another area where I believe we ought to be thinking through the possible advantages to be gained from greater flexibility is in the Federal Reserve's regulation of maximum interest rates on deposits. Certainly, we are well aware that these regulations have sometimes placed the commercial banker at a disadvantage in the competition for deposits. The original purpose of such regulations was to protect the soundness of bank assets from destructive competition, and I believe there is still a good deal to be said for this position, particularly as it relates to the prohibition of interest payments on demand deposits. Still, it would be surprising if some of the underlying conditions had not changed in the nearly three decades since these regulations were established. One obviously relevant development is the enormous growth of other institutions competing for savings—institutions which are regulated as to rate much less stringently or not at all. And there are the greatly expanded markets for Treasury bills and commercial paper of various sorts, which tend to be close substitutes for time deposits as a means of holding funds for various domestic and foreign accounts.

Now as a general rule, I am in favor of imposing as little regulation as possible on our economy, consistent with such broad aims as the promotion of a healthy expanding economy served by sound financial institutions—and I am sure that most of us could agree on this general philosophy. In line with this, I would prefer that individual interest rates be set by free competitive forces in the financial markets, whether these be rates on new issues of Treasury bonds or rates on bank deposits. But I also recognize that, given the great multiplicity of banks and other financial institutions which would be potentially competing with one another for funds, possibly reaching out for riskier assets in order to provide the income to meet higher payments to depositors or shareholders, there is good reason for proceeding cautiously here. Perhaps

a useful first step in this area, which might be given wider general consideration, would be to draw a clearer line between savings deposits and those other time deposits of commercial banks which are basically different in function. Such distinctions have been made by many banks, to be sure, under various circumstances, but without any widespread understanding among depositors of the differences in the nature of the deposits involved. It is the closer study of such possible differences in basic characteristics, and of their implications for bank portfolios and for the interest payable on these deposits, that I am suggesting here.

In pursuing my theme of the need for continuous review of the methods and the principles of monetary policy, I would like to touch on one area of concern that I found mentioned rather widely during a recent visit to Europe. There was a feeling of some bewilderment over the wide swings, both upward and downward, that have occurred in our market rates of interest over recent months. While our friends abroad can, I gather, understand in terms of supply and demand factors some easing off from the high interest rates of late 1959, they have difficulty in grasping the significance of the gyrations we have been having, particularly in the short-term market. Of course, I do not claim to have a full explanation, but surely one important aspect is that "nonbanks" ordinarily play a much larger role than the banks in the securities markets of this country, and that in the shorter term part of the market nonfinancial corporations have been a major, and at times dominant, factor. Thus short-run shifts in corporate cash positions that might in other countries be largely absorbed within the banking system itself are, in this country, thrown more directly upon the open market. More broadly, there has been a great increase in this country over recent years in the number and variety of professional investors, each intent on anticipating before anyone else the effects of any substantial change that may be coming into the market—whether this be an expected reversal in economic conditions, or in the absorption or release of funds by the Federal Government, or even a presumed change in Federal Reserve policy.

Now there is undoubtedly room for closer study of the timing and techniques of fiscal operations, debt management, and monetary policy, with a view to minimizing some of the recent causes of extreme fluctuations without impairing the responsiveness that is essential for full reflection of basic supply and demand conditions in the money and capital markets. But pending such an evolution, it is important to understand that interest rate changes, in the free market conditions of this country, are the resultant of a much wider range of influences,

reflecting a much greater variety of participation, than exists in the money and capital markets of any other leading country. By the same token it is not possible, therefore, to read the same significance into market rate fluctuations here that might attach to similar fluctuations in markets abroad.

Finally, just a word as to the implications for United States monetary policy of the relatively new situation in which we find other powerful industrial countries able to compete with us on even terms in international trade, with international capital flowing more freely than in several decades in response to relative levels of interest rates. I have no doubt whatever of our ability to cope with this new set of facts successfully. So far as any short flows are concerned, as the result of swings back and forth in interest rate differentials between New York and foreign financial centers, our reserves are certainly more than ample to absorb them. Doubtless the monetary authorities must give closer attention than in past years to balance-of-payments problems, with careful analysis of international flows of funds to detect any pointed implications that they may carry for the domestic economy—and these implications then become part of the overall appraisal which determines general monetary policy.

Although requirements of domestic stability must come first, in the working-out of actual policy decisions, capable management of our domestic affairs carries the key to the attainment of that reasonable equilibrium in international payments which will preclude any long-persisting drain on our reserves. It is on such considerations that confidence in the dollar as the world's key currency has been and must be based.

My remarks to you today have ranged quite widely over a number of rather distinct topics, including long-term growth in the money supply, the significance of changes in liquidity ratios, the desirability of greater flexibility of interest rates on bank loans and deposits, the recent behavior of market interest rates in this country, and the general problem of adapting American monetary policy to a more competitive world. Running through our consideration of all these questions, however, is the central theme that monetary policy can never be reduced to a static, inflexible set of rules in a dynamic market economy. But that kind of economy, intended to provide the maximum degree of freedom of choice for the consumer and the producer, for the borrower and the lender, is one that all of us, bankers and nonbankers alike, should find most stimulating and rewarding.

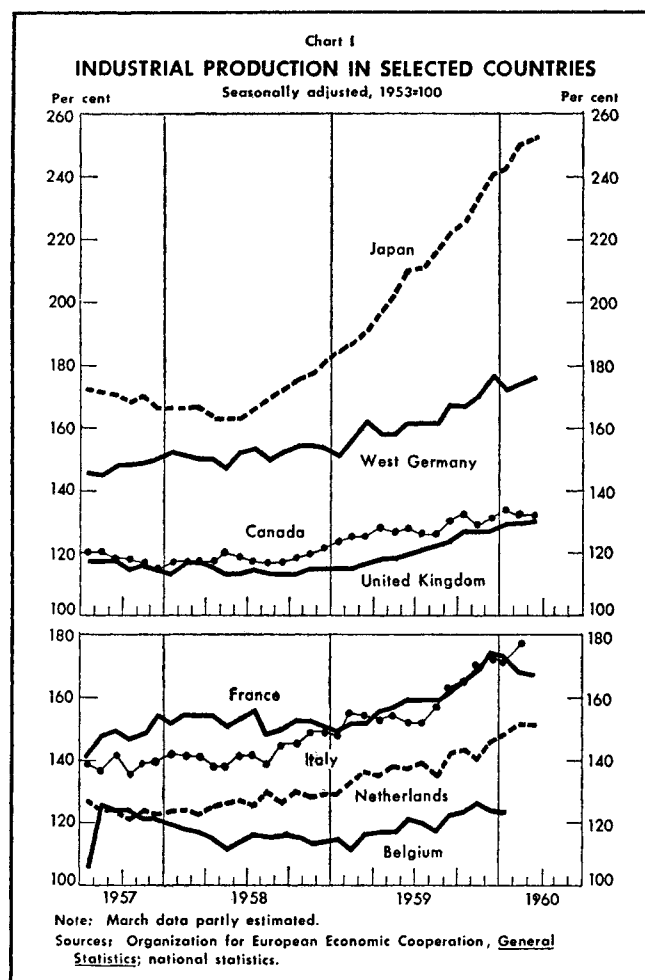
International Developments

BUSINESS TRENDS ABROAD

After a year of economic boom in most major industrial countries abroad, the pace of the advance appears to have slowed somewhat in early 1960, although the underlying expansionary forces generally remain strong. In some countries, the slower rate of expansion in the first quarter seems to have reflected increasing pressures on plant capacity and the spread of labor shortages. Nearly everywhere in Western Europe, moreover, the rapid rise in activity at the year end, which had reawakened fears of inflationary pressures in many quarters, called for a period of readjustment and consolidation. In most countries, however, it is expected that a continuation of the current pattern of rising wages and multiplying labor shortages will swell the demand for consumer goods and induce further investment in coming months. While seasonal influences have contributed to an easing in the threat of price pressures since last fall, the danger remains that the expansionary process may generate excessive demand. As

a result, there has been no substantial departure from the policies of fiscal and monetary restraint that had been adopted earlier.

The less rapid pace of the expansion after the turn of the year is indicated by the slower growth of industrial output in the first quarter in a number of countries (see Chart I). In Western Europe as a whole, industrial production (seasonally adjusted) showed an estimated increase of only about 2 per cent above the fourth quarter of 1959, after a rise of over 4 per cent from the third to the fourth quarter of last year. The advance continued to be marked in Italy and in the Netherlands, where first-quarter output expanded by about 4 and 5 per cent, respectively. In the United Kingdom, the expansion proceeded at only a slightly slower pace than last year. In most other parts of Western Europe, notably in Germany and the Scandinavian countries, industrial output expanded little beyond the high levels achieved in late 1959, while in France there was even a decline from the December 1959 peak. In Japan, the expansion continued at a very rapid pace in the first quarter. In Canada, where the cycli-



cal upswing has so far been modest, the economy since the beginning of the year has apparently been moving sideways, although above the level of the fourth quarter of 1959.

The most rapid production advances in manufacturing continued to be in the basic industries and in automobile production. Iron and steel output abroad showed little or no sign of slackening after the settlement of the United States steel strike, and set new all-time records in March. In the United Kingdom and West Germany, first-quarter production was running 30 and 35 per cent ahead of a year earlier. Moreover, new orders for iron and steel were still flowing in at a rapid rate; in March, they were reported at about 15 per cent above their year-earlier level by the steel industries of the European Coal and Steel Community. The chemical industry also continued to expand rapidly in most industrial countries—particularly in Italy, where output by February had risen nearly 20 per cent above December. Automobile output showed substantial

further gains in the first quarter, topping year-earlier levels by 30 and 50 per cent in West Germany and the United Kingdom.

On the other hand, although production in most of the other consumer durables industries remained high, a number of these industries experienced a decline in new orders. In some countries, a similar situation prevailed in the textile industry, which may be facing a softening of consumer demand.

In the capital equipment industries, the expansion of production continued to proceed at rates which varied widely from country to country. In some countries, where a capital equipment boom was already under way last year, the high level of activity in these industries has continued unabated; in Japan, machinery output in early 1960 was still over 50 per cent ahead of a year earlier; and in West Germany, although the output of capital equipment rose 15 per cent in the first quarter, new orders in March were still running about 25 per cent ahead of deliveries. In the United Kingdom, where a pickup in these industries has been under way only for a few months, machine-tool orders rose in February to a record level, double that of a year earlier and pointing to a continuation of the upturn. On the other hand, in Belgium and France, where investment was still expanding only slowly in the first quarter, the rise in activity of the equipment industries has been quite small.

The boom in the construction industry has if anything gathered further steam in most Western European countries. In the early months of this year, this industry was subject to increasingly serious strains in several of these countries, as a rise in business investment in new plant was superimposed on high levels of residential construction. In West Germany, where the estimated value of business construction approved in January and February was about 30 per cent higher than a year earlier, an 8 per cent rise in building costs within a year and an acute shortage of construction workers are slowing the expansion of the building sector. In the United Kingdom, the Minister of Housing expects that the number of houses to be completed this year will be the largest since 1954. Elsewhere, the building boom reached such proportions as to evoke restrictive government action (described below)—in Denmark at the end of February, in the Netherlands in March, and in Sweden in April. In Switzerland, where the industry was already under considerable strain at the year end, a government spokesman expressed the view that construction plans for 1960 could not possibly be carried out.

Both in the construction industry and elsewhere, the labor markets continued to tighten in most of Western

Europe. The relaxation of pressures on employment which usually develops toward the end of the year lasted only a few weeks into 1960, so that by the end of the first quarter labor shortages were generally as great or greater than during the seasonal peak in industrial activity in the second half of last year (see Chart II). In West Germany, the labor market has not been so tight since 1945; by the end of March, job vacancies were almost double the number of persons seeking work and, with an accentuation of this trend in April, efforts were made to recruit labor from Spain and Greece. Unemployment also returned to well below vacancies in the Netherlands in March. In the United Kingdom, the localized shortages of skilled labor noted last year were reportedly spreading, and by May the rapidly narrowing gap between registered unemployment and unfilled vacancies had almost disappeared. The shortage of skilled workers, notably in the metal and

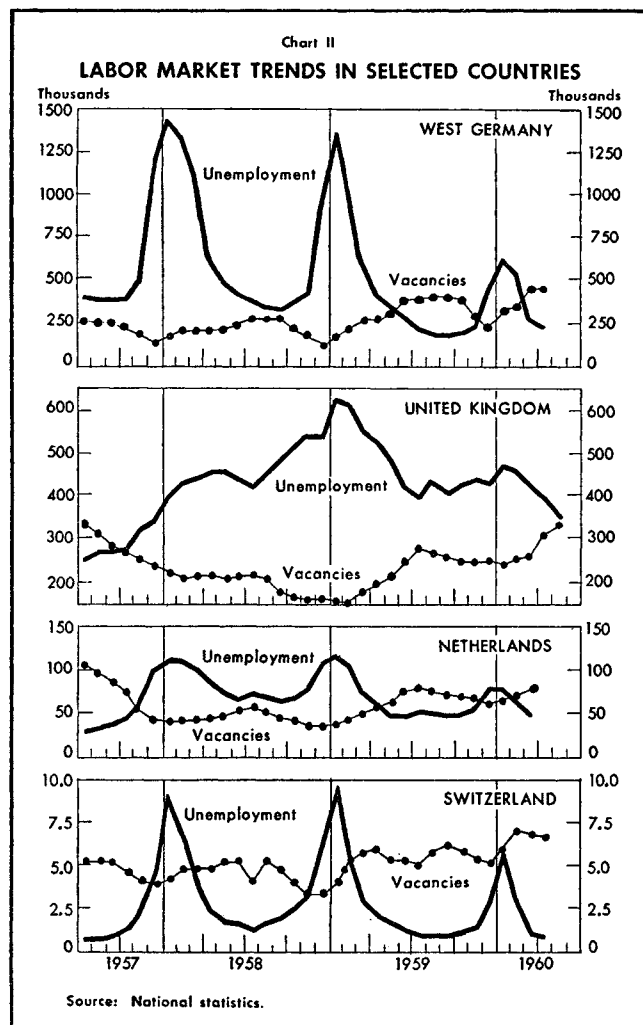
construction industries, also increased in the Scandinavian countries, as well as in Switzerland, where the employment of foreign workers rose to record levels for this time of the year. In Canada, by contrast, employment improved but little in the first quarter of this year, and unemployment rose above its year-ago level in February and March.

Last year's business expansion abroad, which in general had initially been supported by rising domestic consumption and exports and was subsequently reinforced by a pickup of business investment in plant and equipment, apparently owed some of its year-end exuberance also to an unusual rate of inventory accumulation. A subsiding of the flurry of stockbuilding activity in some cases contributed to the slowing-down of the expansion in the early weeks of 1960. Nevertheless, all major components of demand remained high in the first quarter, and sustained growth is generally expected for the remainder of this year.

Exports, on a sharp upward trend since last year in most industrial countries, generally declined less than seasonally after the year end. The exports of most Western European countries and those of Japan continued at record or near-record levels in the first quarter. Canadian exports, which had been increasing steadily through February, declined somewhat in March and April on a seasonally adjusted basis.

Business fixed investment has remained strong. Plans for investment generally continue to be revised upward, as dwindling excess capacity, spreading labor shortages, and keener international competition make it imperative to expand capacity, modernize equipment, and rationalize production. The capital investment boom has, if anything, intensified in West Germany, and also in Japan where it is expected to continue in 1960 at the same lively pace as last year. In the United Kingdom, first-quarter figures on industrial-building approvals and machine-tool orders confirm earlier impressions that 1960 will see an investment boom rivaling that of 1955, with the automobile industry, steel, and to a lesser extent chemicals playing a major role in the expansion. In France, where industrial capacity is still ample and private investment plans therefore remain relatively cautious, an official survey disclosed that in February businessmen were planning to expand their investments in 1960 by about 8 per cent over 1959.

Consumer demand, supported by the 1959 rise in earnings and employment, generally remained high in the first quarter of 1960. Although consumption briefly showed signs of softening in a few countries after the year-end peak in consumer spending had passed, substantial wage increases are generally expected to assure a steady uptrend



this year. In France, department store sales and automobile demand, which had been reported weak in January and February, apparently picked up in March. In West Germany, retail sales in the first quarter were about 4 per cent above a year earlier. In the United Kingdom, where consumer spending showed no signs of slackening, retail sales in the first quarter were 5 per cent higher than a year ago. In Canada, retail sales in the first quarter were running at about the same level as last year.

In most industrial countries, prices in general changed only slightly in the early months of 1960. Both consumer and wholesale prices, which had been on the uptrend nearly everywhere in the second half of last year, generally leveled off in January, largely owing to a seasonal decline in food and fuel prices. However, prices of manufactured products and services continued to edge up in most countries. In West Germany, wholesale prices of manufactured consumer goods rose by 1 per cent during the first quarter. In the United Kingdom, the consumer price index remained stable in the first quarter but rose by $\frac{1}{2}$ per cent in April, partly as a result of the excise-tax increases in the new budget. In France, where last autumn's upward drift in prices was most pronounced, and where the consumer price index climbed another $1\frac{1}{2}$ per cent in January, there was little further change through April. However, the French wholesale price index rose by nearly 1 per cent in April as a result of higher farm prices and a recent rise in steel prices.

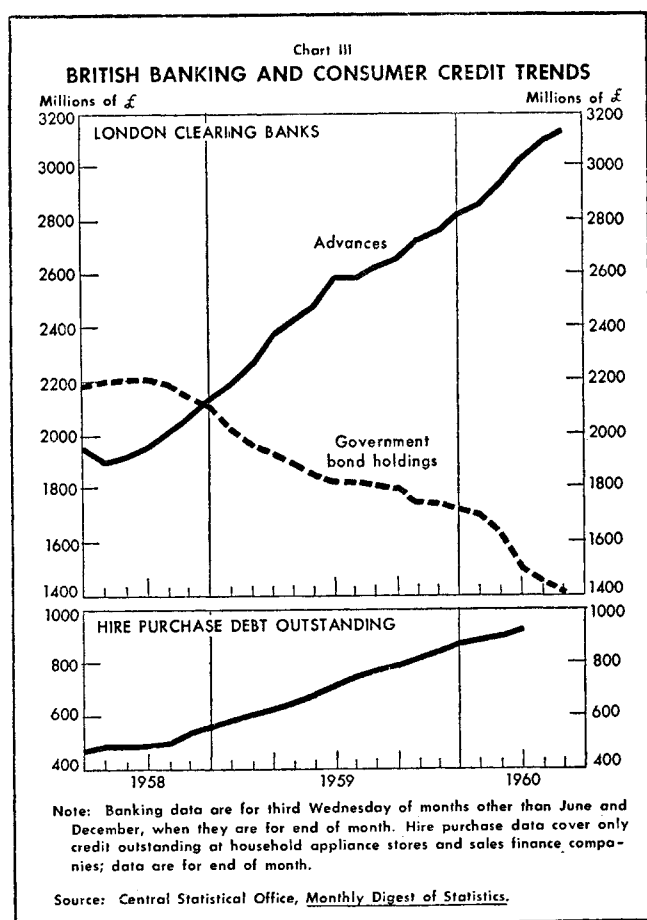
Although the stability of prices in the first quarter has considerably eased fears of renewed inflationary pressures, during the remainder of this year prices in a number of countries will be subjected to considerable pressure from the continued upward movement of wages. In West Germany, wage increases granted so far this year have been appreciably in excess of the 3 to 4 per cent average productivity increase recently mentioned as probable for 1960 by the German Federal Bank. Most recently, government employees have won increases ranging from 7 to 12 per cent, effective June 1, and negotiations scheduled this month are expected to lead to wage boosts in industries employing about one fourth of the country's labor force. In the United Kingdom, where contracts so far concluded have provided for sizable increases, weekly wage rates rose by about 1 per cent during the first quarter. British railway workers, who received a 5 per cent interim wage increase in February, are expected to secure a total gain of 8 per cent when a final settlement is reached. Dutch unions, which have now concluded most of their major contracts for this year, generally obtained a 5 per cent wage increase as well as other benefits; to this has been added, beginning April 1, a general wage

increase averaging over 3 per cent, which was decreed by the government to offset a general increase in rents as of that date. In France, where the government has attempted to restrain labor's demands in order to preserve the benefits of last year's stabilization program, wage claims continue to be pressed vigorously and minor strikes are reportedly multiplying. A seasonal decline in the cost of living in March averted a 2.5 per cent increase in the index-tied minimum wage; nevertheless, during the first quarter, average hourly rates in private industry and trade are estimated to have increased by about 1.5 per cent, with workers in the nationalized industries and the civil service being awarded raises that will aggregate 8 and 5 per cent, respectively, by the end of the year.

MONETARY TRENDS AND POLICIES

Against this background of further expansion of economic activity and emerging labor shortages, the monetary authorities in most foreign industrial countries continued to pursue the policies of monetary restraint that had been adopted last fall and strengthened during the winter. During the past three months, however, new monetary measures were less numerous than toward the end of 1959 and in early 1960. In some major countries, moreover, the banking system managed to remain fairly liquid—thanks largely to the continued inflow of foreign exchange—and interest rates either rose little or actually declined. In a number of instances, the efforts of the monetary authorities to curb credit expansion received the support of other official anti-inflationary measures.

In the United Kingdom, the Chancellor of the Exchequer in his April 4 budget message had foreshadowed fresh credit control measures. These were announced on April 28, when the Bank of England issued a call for "special deposits", equal to 1 per cent of the London clearing banks' (and $\frac{1}{2}$ per cent of the Scottish banks') gross deposits, to be made with the Bank of England by June 15. This call is the first under an arrangement announced in July 1958, according to which the deposits are to carry interest based on the going rate for Treasury bills, but are not to be eligible for inclusion in the banks' minimum holdings of cash and other liquid assets. The Bank of England's move followed in the wake of a steady increase in clearing bank advances (see Chart III); during the five-week statement period ended April 20 alone, such advances rose by £88 million, the largest such rise for any statement period since mid-1959. (In the subsequent four-week period, the rise in advances slowed down to £39 million.) Furthermore, following a rapid increase in hire purchase debt in recent months to a new peak of £920 million at the end of March, the authorities re-



imposed controls over consumer instalment credit; the new regulations call for a 20 per cent minimum downpayment and a maximum two-year repayment period on instalment purchases of a wide range of consumer durables, including cars, radios, television sets, and household appliances.¹

Elsewhere in Western Europe, the German Federal Bank as of June 1 raised commercial bank reserve requirements by 15 per cent, the fourth increase since last November. The new ratios range from 10.8 to 20.1 per cent against sight deposits, 9.3 to 13.9 against time deposits, and 7.5 to 9.0 against savings deposits—the applicable rate depending on the individual bank's reserve classification. The National Bank of Austria, in its first move to tighten credit during the current economic expansion, on March 17 raised its discount rate to 5 per cent from 4½. Effective April 1, moreover, the bank increased the larger banks' reserve requirements against sight and savings deposits to 9 and 7 per cent from a uniform 5

¹ For a more detailed discussion of recent British financial policies, see "International Developments", *Monthly Review*, May 1960, pp. 86-8.

per cent—the first such change since variable reserve requirements were established in the fall of 1955. With these moves by the Austrian National Bank virtually all Western European central banks have now acted—either by concrete measures or by warnings—to curb credit expansion. In some countries, moreover, the introduction of new credit controls is being considered. In the Netherlands, negotiations have been reported under way between the central bank and representatives of the commercial banks and agricultural credit cooperatives concerning the possible introduction of special compulsory noninterest-bearing deposits at the central bank during periods of excess liquidity of the banking system. According to the Netherlands Bank's annual report for 1959, such deposits—which would be in addition to the prevailing minimum reserve requirements—would be linked to credit ceilings that the central bank would establish; the special deposits would be required whenever a bank's lending exceeded its ceiling. The Bank of France in its 1959 annual report similarly indicated that it was currently studying new methods of controlling commercial bank liquidity, to be used if presently available weapons proved insufficient.

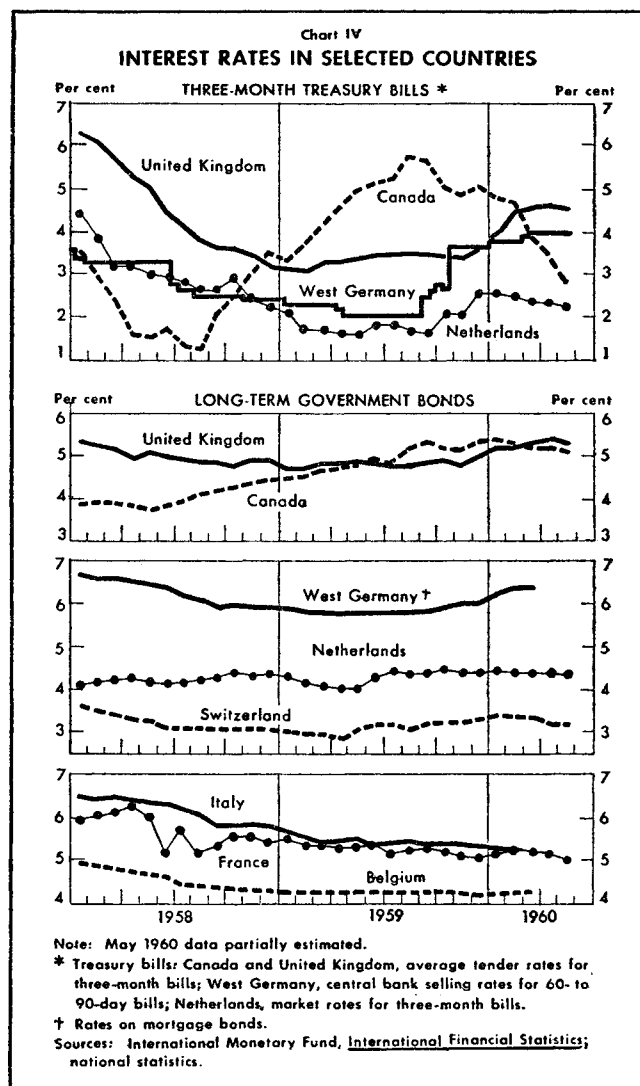
But beyond such actual or proposed measures, central banks in the industrial countries abroad also continued to issue strongly worded warnings against the perils of economic overexpansion and often called for closer cooperation by the various economic sectors with the financial authorities, as well as between the monetary and fiscal authorities. Thus, the German Federal Bank in its annual report for 1959 warned in late April that it would make even stronger use of its credit control powers if demand continued to outrun growth in output. The bank also appealed to the public authorities to re-examine their spending plans and to reduce their borrowing to a minimum. In Sweden, the governor of the central bank at a meeting with the commercial banks in April, reiterated his warning against further credit expansion and called on the banks to show greater restraint in their lending operations. The National Bank of Denmark similarly appealed to the banks to exercise restraint in granting consumer credit, while in Switzerland banks and other financial institutions heeded the National Bank's earlier request by putting a halt to the setting-up of new investment trusts.

In several of the industrial countries, these and earlier moves in the money and credit fields were supplemented in the past three months by other official anti-inflationary measures. Thus, in Australia—where earlier this year almost all import restrictions had been abolished and commercial bank reserve requirements had been increased—the official Arbitration Commission in April rejected at the behest of the government the unions' demands for a

further substantial raise in the basic wage and for the restoration of automatic quarterly cost-of-living adjustments. The commission's decision, which contrasted with a number of substantial wage awards during the past few years, was followed by an official suggestion that manufacturers, now virtually assured of wage stability in 1960, should concentrate on translating productivity gains into lower prices.

Steps to slow the pace of construction activity were taken in three European countries. The Danish government ordered a one-month freeze on the issuance of building permits in Copenhagen and several other large cities, and the Swedish authorities suspended government-subsidized residential projects until the fall; in the Netherlands, following a 5 per cent wage increase in the construction industry, the authorities froze the prices charged by builders. The Dutch and Swedish fiscal authorities are also attempting to moderate business investment during the current phase of high-level economic activity. In the Netherlands, special investment allowances and accelerated depreciation privileges have been reduced, while in Sweden tax concessions, applicable in 1961, have been proposed for business firms that before November 1 deposit with the central bank additional investment reserves, to remain blocked until the end of 1961.

In Canada, in contrast to Western Europe, monetary and credit conditions generally eased further during most of the period under review. While chartered bank loans turned up slightly, mainly for seasonal reasons, in mid-May they still were 5.3 per cent below last September's peak. Throughout most of the period, the Bank of Canada remained a heavy purchaser of Treasury bills, thus helping to cushion money market pressures. The average Treasury bill tender rate dropped by a record 160 basis points to 3.01 per cent during the five weeks ended March 31 and declined further during April and May (see Chart IV). In view of the prospects for further expansion in economic activity this year, the new budget for the fiscal year that began on April 1 avoids providing an additional stimulus to the Canadian economy. With expenditures estimated at \$5,880 million—only \$173 million above those of 1959-60—and revenues expected to rise by \$591 million to \$5,892 million, the fiscal year is expected to close with a small surplus, as against a \$406 million deficit in 1959-60. In mid-March, the government undertook a refunding operation that for the first time featured competitive bidding for part of the new bond issue; a similar refunding, with the whole amount of the new securities sold at competitive tender, was made last month. In both instances, tenders were accepted for the full amounts offered at average rates close to current market yields.



The starting of operations by the Bank of the Republic of Guinea on March 1 marked the debut of the world's youngest central bank. The new institution, which has taken over in Guinea the central banking functions of the French-organized Central Bank of the West African States, thus joins other central banks that have recently been created (in some cases succeeding existing institutions) in a number of newly independent countries. In addition to Guinea, new central banks have begun operations since the beginning of 1959 in Malaya, Morocco, Nigeria, and the Sudan.

EXCHANGE RATES

In the New York foreign exchange market, both the pound sterling and the Canadian dollar were under pressure during May. Although there was occasional good

commercial demand for spot sterling, it was more than offset by persistent sterling offerings from the Continent. After the cancellation of the summit conference in Paris at the midmonth, these offerings increased substantially, causing a marked decline in the spot quotation. Following a brief partial recovery in the rate, Continental offerings were renewed and, with some commercial selling of sterling and commercial demand for dollars in London, depressed the quotation by May 31 to \$2.8019, a decline of about 75 points for the month.

In the forward market the discounts on three and six months' sterling generally narrowed to 39 and 76 points, respectively, by mid-May. Subsequently, they tended to widen and at the month end were 46 and 86 points. Although there was some commercial activity, the discounts continued to reflect primarily adjustments to the short-term interest rate differential between London and New York.

The Canadian dollar, quoted at \$1.03 $\frac{1}{8}$ at the beginning of May, steadily weakened, reaching its lowest level since January 1958. Market reaction to the withdrawal from registration of a Canadian municipal bond issue

scheduled for the New York market (subsequently marketed in New York toward the month end) brought about an initial easing in the Canadian dollar quotation. Thereafter, short-term interest yields declined in Canada, and Canadian dollars were offered as short-term funds began to move to the Continent. This, together with substantial offerings of Canadian dollars by United States commercial interests and demand for United States dollars by Canadian commercial interests, forced the rate for the Canadian dollar down to a low of \$1.01 $\frac{1}{8}$ by May 25. After recovering to \$1.01 $\frac{3}{4}$ on covering of short positions, the Canadian dollar again moved lower to \$1.01 $\frac{1}{2}$ at the month end.

The quotation for the Swiss franc, which had been depressed for some months, began to appreciate at the beginning of May, as investment capital was repatriated, and by May 24 stood at \$0.2318 $\frac{3}{4}$, the highest quotation this year.

The Russian ruble, it was announced early in May, would be revalued next year on the basis of one new ruble for ten old. Currently, tourists are receiving ten rubles for one United States dollar.

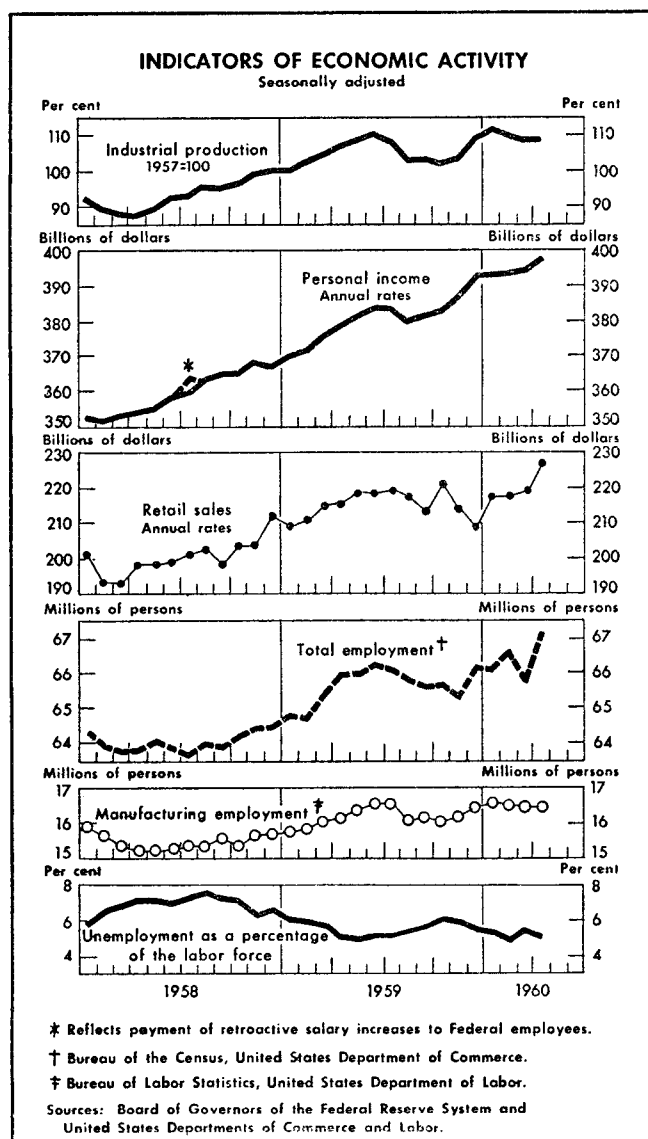
The Business Situation

Economic activity in May appears to have steadied at the high levels achieved in April. Automobile sales, which had risen in April, contributing much to that month's better tone, maintained the same pace during the first twenty days of May as during the comparable period of April. Early information on department store sales suggests, however, that in a number of other lines there may have been some declines from the very high April sales figures. Total factory output in May does not seem to have been pushed up by the substantial April expansion in consumer demand. Still, not all consumer purchases were met by further drawing-down of inventories, and production in some industries—including automobiles—registered further gains. The prospect, moreover, of later increases in production elsewhere was indicated by a recent survey of consumer buying plans, which showed buying intentions for many items to be stronger than a year earlier.

The information that has now come in for April confirms that most over-all measures of economic activity improved substantially during that month, but in some cases the advance seemed to be in large measure only an offset to the disappointing performance of the preceding month or two.

In mid-April, total employment (as computed by the Bureau of the Census, and including farm workers, the self-employed, and domestic workers) moved up sharply to a new all-time high, seasonally adjusted (see chart). The increase resulted primarily from a more-than-seasonal rise in agricultural and construction employment—probably making up for the slow hiring of workers for these outdoor industries during the unusually wintry March. The figure was also pushed up by the hiring of more than 150,000 temporary workers to take the decennial Census. Manufacturing employment (as estimated by the Bureau of Labor Statistics) was unchanged from mid-March, on a seasonally adjusted basis (see chart). This stability concealed important divergent movements, however; employment in durable goods industries declined by 66,000 persons, while in nondurables it increased by an equal amount.

Many of the people hired in April were seasonal or temporary workers who had not been listed as unemployed at the time of the previous Census Bureau survey in the middle of March. Therefore, the decline in unemployment was not so large as the rise in employment, and the number of unemployed remained fractionally higher than a year



earlier. As a proportion of the civilian labor force, however, unemployment fell from 5.4 per cent to 5.0 per cent, seasonally adjusted. This brought it close to the 2½-year low of 4.8 per cent reached in February this year.

With total employment up sharply in April, personal income showed a larger gain, seasonally adjusted, than in any other month in 1960 (see chart). Indeed, the \$3.4 billion rise was almost double the increase over the entire first quarter. All major components either rose or at least remained unchanged. The largest improvement was in wages and salaries, although manufacturing wages and salaries fell for the third consecutive month. The April decline in manufacturing income apparently reflected mainly a reduction in hours worked and in overtime, pre-

mium pay, but it may have been partially a result, too, of the contraction in factory employment in durable industries, where wages are relatively high.

Retail sales in April increased, seasonally adjusted, by 3½ per cent (based on the advance report). This rise was far better than the increases during February and March (see chart), and a similarly sharp advance had occurred in just three other months since the business upturn in 1958. Even more significant, the increase was more than twice as large as the April advance in personal income. This resulted in a substantially higher spending-income ratio, and thus helped make up for the retarding effect on economic activity of a currently slowed rate of inventory accumulation.

In May, total retail sales may have remained at about the high April level. Automobile sales during the first twenty days of the month were about equal to the first twenty days of April, maintaining the relatively high level reached in the latter period. Department store sales during the first three weeks of May were slightly below the levels achieved a year ago, suggesting that for the month as a whole seasonally adjusted department store sales may have fallen below the very high April figure.

The climb in retail sales during April pushed up orders for nondurables received by manufacturers, but orders for durables declined by an equal amount, possibly largely as a result of the continued drop in steel orders. The March-April level of total new orders was 1 per cent (seasonally adjusted) below the February total.

Industrial production also leveled off in April, at 109 (1957 = 100), seasonally adjusted, following a small two-month decline (see chart). Substantial increases were registered in mining, in petroleum products, and in such consumer durables as autos and furniture. As a result, the index moved sideways despite a further decline in the output of iron and steel, fabricated metal products, electrical machinery, and transportation equipment.

Automobile production, which had fallen off about 15 per cent between the January peak and April, rose in May, in response to strong sales during the preceding weeks. Although automobile inventories were still at the high level of about one million units at the end of April—partly reflecting larger inventory requirements associated with the greater variety of models—the faster sales pace apparently convinced producers that inventories were not too large for this time of year. In contrast, steel production continued its sharp decline into the fourth successive month, with mills utilizing less than 70 per cent of rated capacity, compared with the above 95 per cent levels prevailing at the turn of the year when steel inventories were being rebuilt following the steel strike. Officials of the top

steel companies, however, are of the opinion that steel consumers are using up more steel than is being currently produced. They consequently foresee an upturn in production after the usual summer lull, during which steel users' inventories are expected to fall to minimum levels compatible with efficient production.

Prices at the wholesale level seem to have moved slightly downward in May after remaining unchanged, on the whole, in April. The monthly index of all prices stood in April at 120.0 (1947-49 = 100), exactly the same as a year ago. The industrial commodity prices component had nudged up $\frac{1}{10}$ of a point from March, to a level $\frac{3}{10}$ of 1 per cent above April 1959. Of the two other major components, farm products moved up and processed foods down; both, however, were below year-earlier levels. The weekly figures thus far available for May show movements in the indexes of farm products and of processed foods that approximately offset each other, while the industrial commodities component remained steady at a level a bit below the April monthly figure.

Although the wholesale price index was steady in April, the consumer price index set another record high, advancing to 126.2 per cent of the 1947-49 average, $\frac{4}{10}$ of 1 per cent above March and almost 2 per cent more than the previous April. The major reason for the March-to-April increase was a sharp rise in food prices, apparently attributable in part to seasonal advances and unusually bad spring weather. Partially counteracting the hike in food prices was a decline in the transportation component, the fifth in as many months; the April drop resulted entirely from a further decline in used-car prices. All other major components of the consumer price index advanced slightly.

The prospect that economic activity may be spurred by a further pickup in consumer demand is suggested by the continuing survey of consumer buying plans conducted by the National Industrial Conference Board with the

financial sponsorship of *Newsweek* magazine. A recently published analysis of February and March interviews indicated that more consumers plan to buy new automobiles, new and old houses, and certain major appliances this spring and summer than had been the case a year ago. For a few items, namely used cars, television sets, and clothes dryers, buying plans were below a year ago.

These plans are of considerable interest in the light of the developments in retail sales and home building during the last several months. Sales by "furniture and appliance" stores have constituted one of the weakest components in retail sales; in March (when bad weather may have contributed to the low level), they were 8 per cent, seasonally adjusted, below their August 1959 high. The softness of the furniture and appliance markets would seem to have been associated in part with the decline since last spring in home completions, and an improvement may therefore depend upon an upturn in residential construction. It is probable, moreover, that retail sales of "lumber, building, and hardware" outlets—the one other component that in recent months has been considerably below last year's peak—would also benefit from the rise in the purchase of homes that is indicated by the survey.

A further positive influence on economic activity is also to be expected from business spending for new plant and equipment. The actual volume of outlays does not yet seem to have reached the levels indicated by surveys of business capital plans taken a few months ago, and new orders for machinery have shown little tendency to rise. There is no evidence, however, that business spending plans have been scaled down in the aggregate. Contract awards for private nonresidential construction appear to have risen in April for the second consecutive month by more than is usual at this time of year. In addition, preliminary May figures show construction outlays in this sector unchanged from April, following a two-month decline.

Money Market in May

Aggregate reserve positions of all member banks eased perceptibly in May, although the extent of the easing was not wholly reflected in the money market. Banks in the money market centers in particular were under diminished immediate reserve pressures, and Federal funds trading frequently took place below 4 per cent. Rates on loans to Government securities dealers at the New York City banks were generally in a $4\frac{1}{4}$ - $4\frac{1}{2}$ per cent range until the tenth

of the month and then in a $4\frac{1}{2}$ - $4\frac{3}{4}$ per cent range until the final week, when they were a uniform $4\frac{1}{2}$ per cent.

In the Government securities market, yields continued the zigzag pattern of the previous month—moving down steadily in the early part of May, turning up again to offset these losses, and then declining once more toward the close of the period. The early decline in rates reflected in part the Treasury's completion of its \$6.4 billion re-

funding but, in addition, the reduction of bank rates on loans to brokers and dealers secured by customers' stock exchange collateral was interpreted by some observers as a harbinger of easier credit conditions. Subsequently, however, encouraging news on the business situation, the collapse of the Paris summit talks, and news of the Treasury's plans to raise more funds through increased offerings at the weekly bill auctions tended to push yields up. Toward the end of the month rates again eased off, and rates generally showed a net decline over the month.

MEMBER BANK RESERVES

Federal Reserve open market purchases during May more than offset losses of reserves experienced by member banks as the result of regular market factors, so that overall reserve availability increased. The chief factors withdrawing reserves were an increase in currency in circulation and Treasury interest payments to the Federal Reserve Banks—the latter reflected in an increase in the item "other deposits, etc." shown in the table—which together overbalanced the influence of a decline in required reserves. Contributing to the greater availability of reserves

at the larger city banks were heavier than expected Treasury tax receipts which resulted at times in large temporary redeposits to the Treasury's accounts with "Class C" depository banks. These deposits were subsequently drawn down by the Treasury.

System Account operations over the first two statement weeks ended in May supplied about \$350 million in reserves to prevent undue monetary tightness during the Treasury's refunding operations. During the remainder of the month reserves were absorbed on balance, as the repurchase agreements made earlier by the Federal Reserve System ran off. Federal Reserve holdings of Government securities were increased by \$228 million from April 27 to May 25, as outright holdings of the System Account rose by \$260 million and repurchase agreements decreased by \$32 million. Net borrowed reserves of all member banks declined from the \$178 million April average to \$82 million for the four statement weeks ended in May.

GOVERNMENT SECURITIES MARKET

The Treasury's successful refunding of \$6.4 billion of notes and certificates maturing May 15 was the center of market attention in the early days of the month. Subscription books were open from May 2 to May 4, with delivery on May 16. Market reaction to the announcement was favorable, and both the maturing issues and the new securities (4⅜ per cent one-year certificates and 4½ per cent five-year notes, both offered at par) were bid at modest premiums, of up to ¼ of a point, throughout the subscription period. The new notes and certificates reached bids of 100⅞₄ and 100⅜₂, respectively, in when-issued trading by the close of the subscription period. Attrition on the refunding was only \$627 million, or about 10 per cent of the publicly held maturing issues, as \$4,615 million of the maturing notes and \$1,171 million of the maturing certificates were exchanged for \$2,113 million of the new notes and \$3,673 million of the new certificates.

With the Treasury out of the market and not expected to return until July, a confident atmosphere developed in the intermediate- and long-term sectors of the market early in May. The market was further buoyed by the May 6 reduction to 5 per cent—from the 5½ per cent level in effect since early January—of bank rates on loans to brokers and dealers secured by customers' stock exchange collateral. As a result of these developments, prices of most intermediate- and long-term securities made substantial gains, with some issues rising as much as 1⅞ points by May 9 and the new notes and certificates advancing to bids of 100½ and 100⅞₂, respectively.

Subsequently, however, the international crisis, the appearance of several indicators suggesting a stronger busi-

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, May 1960
In millions of dollars; (+) denotes increase,
(-) decrease in excess reserves

Factor	Daily averages—week ended				Net changes
	May 4	May 11	May 18	May 25	
Operating transactions					
Treasury operations*	- 13	+ 62	- 97	+ 60	+ 12
Federal Reserve float	- 201	- 34	+ 209	+ 23	+ 2
Currency in circulation	- 22	- 120	- 51	+ 90	- 103
Gold and foreign account	- 11	- 1	- 11	- 13	- 36
Other deposits, etc.	- 34	- 2	- 68	- 88	- 192
Total	- 281	- 93	- 20	+ 77	- 317
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 113	+ 59	+ 11	+ 91	+ 274
Held under repurchase agreements	+ 26	+ 149	- 118	- 107	+ 50
Loans, discounts, and advances:					
Member bank borrowings	+ 28	- 3	+ 6	- 153	- 122
Other	-	-	-	+ 1	+ 1
Bankers' acceptances:					
Bought outright	-	+ 1	-	- 1	-
Under repurchase agreements	-	-	-	-	-
Total	+ 166	+ 206	- 100	- 170	+ 102
Member bank reserves					
With Federal Reserve Banks	- 115	+ 113	- 120	- 93	- 215
Cash allowed as reserves†	- 34	- 49	+ 48	+ 24	- 11
Total reserves†	- 149	+ 64	- 72	- 69	- 226
Effect of change in required reserves†	- 7	+ 109	+ 37	+ 51	+ 190
Excess reserves†	- 156	+ 173	- 35	- 18	- 36
Daily average level of member bank:					
Borrowings from Reserve Banks	552	549	555	402	515‡
Excess reserves†	325	498	463	445	433‡
Free reserves†	227	- 51	- 92	43	- 82‡

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 May 25, 1960.

ness picture, and a stock market rally—together with the Treasury announcement of plans to raise new funds through expanded offerings of 182-day bills at weekly auctions—shifted market sentiment away from earlier expectations of credit ease. As investor demand dried up and dealers sought to lighten their inventories, irregular price declines generally erased most of the month's earlier gains. Later in the month prices recovered considerably, as higher yields attracted modest investor demand. In addition, as the summit collapse receded into the background, market observers apparently became less certain that the episode would greatly stimulate defense spending. Prices of intermediate notes and bonds were generally $\frac{1}{8}$ to $\frac{9}{16}$ higher for the month as a whole, and long-term bonds were mostly $\frac{7}{16}$ to $1\frac{15}{16}$ higher. At the end of the month, the average yield on long-term Treasury bonds was 4.11 per cent, compared with 4.20 per cent on April 29, while the average yield on 3- to 5-year issues had declined to 4.36 per cent from 4.40 per cent.

Market rates for Treasury bills followed the same general pattern as the longer issues over most of the month. Rates moved lower during the first week of May, as moderate investor demand was supplemented by swaps out of "rights" in the refunding. The average issuing rates on 91- and 182-day Treasury bills, which had dropped by 31 and 36 basis points to 3.003 and 3.349 per cent, respectively, in the May 2 auction, turned up by 27 and 17 basis points the following week, reflecting a lack of broad demand. This upward movement of rates, for outstanding bills and in the bill auction, was accelerated sharply on May 16, apparently in reaction to the unsettling news from the summit conference and to the additional \$100 million offering of 182-day bills. The rates on the 91-day and 182-day bills in the auction on that day jumped 52 and 48 basis points, respectively, to 3.793 and 4.000 per cent—the highest levels since early March. Subsequently, a general feeling that the market had overreacted brought a downward adjustment in rates, as some demand appeared from nonbank investors, with bills maturing through July especially in demand. Although an atmosphere of caution developed during the regular bill auction on May 23, the average issuing rates on both the 91- and 183-day bills were lower than a week earlier, at 3.497 and 3.867 per cent, respectively. Scarcities of most issues and continued nonbank demand, as well as a Treasury announcement that an additional \$100 million of bills in the final May auction would probably wind up its new borrowing operations for fiscal year 1960, pushed rates down further over the remainder of the month. In the May 27 auction, held that

day because of the Memorial Day holiday on May 30, the average issuing rates were established at 3.184 and 3.495 per cent on the 91- and 182-day bills, respectively. On balance over the month, rates on bills due through mid-July were down 29 to 52 basis points, while longer bills generally declined by 5 to 22 basis points.

OTHER SECURITIES MARKETS

Outstanding corporate and tax-exempt bonds experienced much the same price pattern as long-term Government securities, tempered somewhat, however, by the overhang of heavy dealer inventories—especially of tax-exempts. Confidence born of the May 6 reduction in brokers' loan rates brought a short period of brisk investor demand which raised prices and reduced dealers' and underwriters' inventories somewhat. But demand slackened and prices turned downward toward the middle of the month, reportedly reflecting in part some investor switching from the bond market into equities. Toward the end of the month, price movements were mixed. Over the month, Moody's average yields on Aaa corporate bonds moved up from 4.46 to 4.48 per cent, and on Aaa tax-exempts rose from 3.34 to 3.38 per cent.

The volume of new tax-exempt offerings totaled \$494 million, a decrease from the April total of \$633 million but about the same as the \$490 million sold in May 1959. Reception accorded the new tax-exempt issues were selective. A \$133.4 million serial offering comprising thirty issues of Aaa-rated local housing authority bonds, due 1961-2000, was reoffered to yield from 2.40 per cent to 3.90 per cent, and was given an excellent reception with some of the longer maturities moving to premium bids. Flotations of new corporate bonds amounted to \$182 million, less than either the \$340 million sold in April or the \$345 million marketed in May 1959. New corporate issues generally moved slowly. New United States Government agency flotations aggregated \$987 million, of which approximately two thirds represented refundings, and most of the offerings met with good receptions.

Rates on bankers' acceptances, which had not declined in line with the reduction in Treasury bill rates since mid-April, were lowered in $\frac{1}{8}$ per cent steps on May 4, on May 9, and again on May 31, bringing the rate on 90-day unendorsed acceptances to $3\frac{3}{4}$ per cent bid. Except for the May 6 reduction from $5\frac{1}{2}$ per cent to 5 per cent in the rate on New York City banks' loans to brokers and dealers secured by customers' stock exchange collateral, already noted, other short-term money market rates were unchanged during the month.