1914 FIFTIETH ANNIVERSARY 1964

FEDERAL RESERVE BANK OF NEW YORK

MONTHLY REVIEW

AUGUST 1964

Contents

Volume 46 No. 8

The Business Situation

As the second half of the year began, the economy continued to show a solid advance. In June, industrial production, nonfarm payroll employment, and personal income all rose, while retail sales were only slightly below the record May level. For the second quarter as a whole, gross national product moved substantially upward and, with prices remaining relatively stable, most of the rise reflected real growth. Fragmentary data for July suggest that after adjustments for seasonal changes—adjustments which are especially difficult at this time of year—auto and steel ingot production and retail sales apparently increased somewhat. In the residential construction area, leading indicators of activity recovered part of their April-May losses in June, but remained below their average levels of winter and early spring.

The business expansion continues to be accompanied by a substantial degree of over-all price stability. The wholesale price index actually tended slightly downward during the first half of this year, reflecting some easing in the prices of farm products and processed foods and essentially no change in the index for industrial goods. At the retail level, the consumer price index has advanced very little in 1964, with the June figure only 0.4 per cent higher than six months earlier as compared with an 0.8 per cent rise during the first six months of 1963.

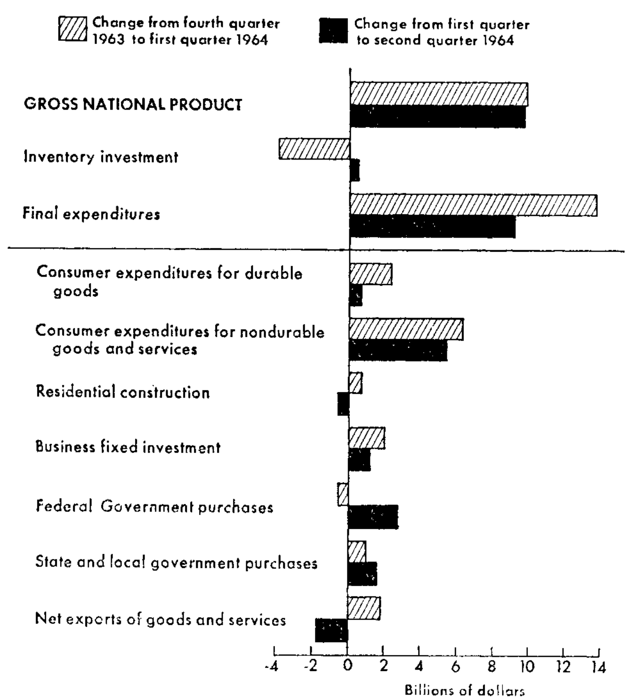
RECENT PATTERNS OF DEMAND

Gross national product rose by $9.7 billion in the second quarter to a seasonally adjusted annual rate of $618.5 billion, according to preliminary estimates of the Department of Commerce (see Chart I).[1] This gain was about equal to that scored in the previous three months, but moderately smaller than the very large increase recorded in the final quarter of 1963. Virtually all the April-June advance was in final expenditures—that is, in GNP exclusive of the influence of inventory changes. Inventory accumulation rose only modestly, after having dropped

Chart I

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted annual rates



Source: United States Department of Commerce.

[1] The usual midyear revisions of the national income accounts resulted in changing the previous estimates of quarterly GNP back through the first quarter of 1961 by as much as plus or minus $2.2 billion, with the figure for 1964-I revised upward by $0.8 billion.

significantly in the first quarter. With stocks remaining conservative in relation to sales, it appears likely that future rises in demand will be readily reflected in higher output.

Consumer spending accounted for about two thirds of the increase in final demand. As noted in a more detailed discussion below, the $6 billion rise in such expenditures during the first full quarter of the tax cut was somewhat less than the huge advance scored in the first three months of the year. However, the latest gain was larger than most of the quarterly increases achieved during the current business expansion. Purchases of nondurables and services were again stepped up strongly, while buying of durable goods rose moderately after a considerable surge in the first quarter. Weekly retail sales data suggest that consumers may have further increased their spending in July, despite the retarding influence on auto sales of a strike by new car haulers in the eastern states.

In the government sector, expenditures at the state and local level during the second quarter continued on their long-term uptrend and Federal purchases also rose significantly. In a somewhat longer perspective, however, it is noteworthy that Federal spending has added much less to aggregate demand in the past year than in the earlier portion of the current business upswing. Continued paring of defense outlays, moreover, is expected to result in lower levels of Federal spending over the rest of the year than were projected in the Budget last January.

Business fixed investment also registered an appreciable rise in the second quarter, continuing the notable strengthening in this sector. Furthermore, the prospect of a sizable advance in capital spending over the balance of the year —indicated in the May survey of businessmen's plans taken by the Commerce Department and the Securities and Exchange Commission—is receiving some confirmation in the strong showing, over recent months, of indicators on contract awards for commercial and industrial construction and new orders for machinery and equipment.

The two components of GNP which fell off in the second quarter are net exports of goods and services and outlays for residential construction. The drop in net exports reflected a substantial increase in imports from an unusually low first-quarter level. As for housing expenditures, the moderate decline was associated with some weakening in April and May in the number of new housing starts and building permits issued as compared with their very high rates during the previous several months. In June, both starts and permits rose by 5 per cent, but remained 6 per cent and 4 per cent below their respective first-quarter averages.

PRODUCTION, ORDERS, AND EMPLOYMENT

The Federal Reserve's seasonally adjusted index of industrial production moved up in June for the tenth successive month, rising by 0.6 percentage point to 131.8 per cent of its 1957-59 average (see Chart II).[2] While the June rise, like the one in May, fell short of the large increase registered in April, it brought the total increase for the first six months of the year to 4 per cent—substantially above the 1 per cent rise in the previous half year, though somewhat less than the large gain achieved in the first half of 1963. The advance in June was rather widespread, encompassing most major market and industrial sectors. Steel and motor vehicle production, however, which contributed significantly to the boost in the index earlier in the year, held about unchanged at very high levels.

In July, steel ingot output—which normally shows a sizable seasonal decline—held about unchanged, reflecting continued strong demand from a broad range of customers. Some trade sources are projecting a record production level of 120 million tons for the year. In the automobile industry—which is currently involved in important labor negotiations—factories were operating at a high rate, as they closed out production of their 1964-model cars in preparation for a longer than usual retooling period to permit substantial styling changes in their 1965 models.

A factor bolstering industrial production has been the steady rise in the backlog of unfilled orders received by manufacturers of durable goods. In June these order backlogs moved up by 1 per cent, to register the sixth consecutive monthly gain (see Chart II). To be sure, the value of new orders received by producers of durable goods remained about unchanged after a moderate decline in the previous month. However, this series would have increased by 2 per cent in June if not for a sharp drop in bookings placed with the defense-oriented aircraft industry, which follow an erratic month-to-month pattern. The over-all level of durables orders, moreover, remained high.

In line with the upward course of economic activity, nonfarm payroll employment (seasonally adjusted) continued to rise moderately in June, increasing by 114,000

[2] The series is in the process of being revised back through January 1961, with the revision largely reflecting the application of newly computed seasonal adjustment factors. Revised totals are available monthly, starting with January 1963; figures for earlier months will be released in the near future. While the data plotted in Chart II are therefore on the revised basis only for January 1963 on, it is not expected that revision of the earlier data will result in any significant change in contour.

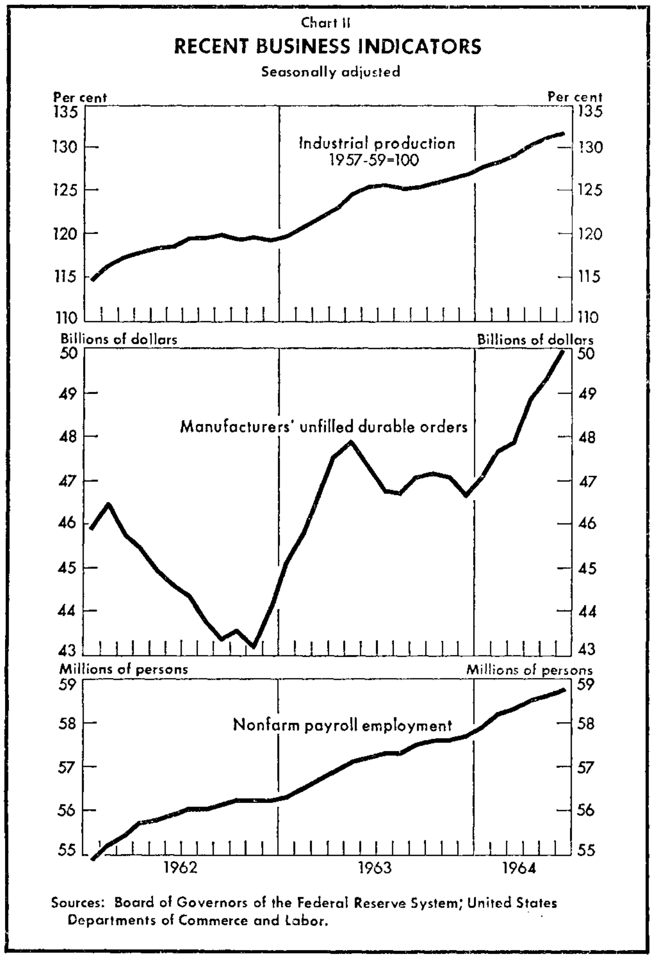


Chart II
RECENT BUSINESS INDICATORS

Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

persons, following an advance of only 49,000 the month before (see Chart II). Most of the June increase occurred in service industries and in state and local government employment. Since the end of last year, the number of nonagricultural jobs has increased by a little over 900,000 —appreciably more than in the previous six months, though slightly less than in the first half of 1963.

RECENT CONSUMER BEHAVIOR

As noted earlier, the American consumer continued to provide a major stimulus to the sustained expansion of the economy in the second quarter. Consumption spending directly absorbs the bulk of the economy's output and indirectly supports business investment in inventories and plant and equipment. While consumption is subject to a wide variety of influences, its most important single determinant in normal times is the level of income available to consumers after taxes—so-called disposable income. One of the main aims of the recently enacted tax legislation was the stimulation of economic activity by increasing disposable income in the hands of consumers; observers of the business scene in recent months have, therefore, been trying to assess the impact of the tax cut on spending.

Certainly there can be little question that the tax cut has given a psychological boost to the economy. And it is reasonably clear that the concrete support given to consumer incomes will—at least after a time—result in higher consumer spending than would otherwise take place. Nevertheless, with data available for only a few months, any attempt to measure the immediate impact of the tax cut on consumer spending is bound to be somewhat frustrating. The relevant economic time series are subject to short-term fluctuations, some of them erratic, and these fluctuations can be large enough to obscure underlying trends. Moreover, no statistical data are completely free of error, and data that must generally be used in analyzing the most recent developments are frequently only preliminary estimates.

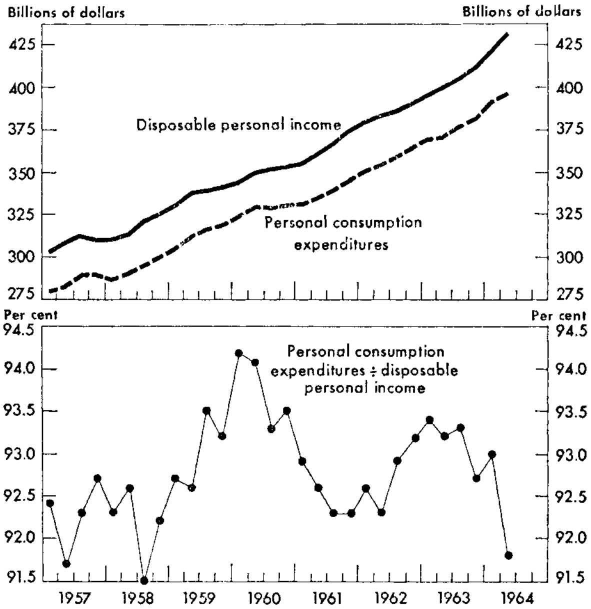
The initial estimates for the April-June quarter, the first quarter in which the tax cut was fully in effect, show a sharp $12 billion increase—see Chart III—in disposable income (seasonally adjusted annual rate), the largest quarterly increase on record. Since before-tax personal income rose by only $7 billion, roughly $5 billion of the increase in disposable income between the first and second quarters is attributable to a decline in tax receipts.[3]

The sizable $6 billion increase in consumption spending in the second quarter was all the more impressive coming after a near-record rise of almost $9 billion in the first quarter. The second-quarter gain, however, amounted to only about 50 per cent of the increase in disposable income. To be sure, if the ratio of additional spending to additional disposable income is measured over the first half of 1964 as a whole, the result is a markedly higher 73 per cent. Yet even this figure is substantially below

[3] Actually, the $5 billion figure probably understates to some extent the difference between actual disposable income in the second quarter and what disposable income would have been had there been no tax cut. First, part of the effect of the tax cut was already felt in the first quarter, since the cut became effective on March 5. Second, in the absence of the tax cut, total income tax collections (which include state and local tax collections as well as Federal personal income taxes) would actually have shown some increase. If this increase is deducted, the estimate of the total effect of the Federal income tax cut on disposable income would be somewhat higher than $5 billion. Finally, it is possible that before-tax incomes would not have been so large in the absence of the generally stimulating effects of the tax cut on the economy as a whole.

Chart III

DISPOSABLE INCOME AND PERSONAL CONSUMPTION EXPENDITURES



Source: United States Department of Commerce.

the usual proportion of disposable income that has been spent on consumption in recent years.

After a burst of spending following the end of World War II, the consumer has consistently tended to spend in the neighborhood of 93 per cent of his after-tax income on goods and services. In individual quarterly periods during the last ten years, this ratio has been as low as 91.5 per cent and in the first quarter of 1955 as high as 94.5 per cent. In the current economic expansion, the ratio—until the second quarter of this year—moved within a narrower range of 92.3 per cent to 93.4 per cent (see Chart III). Small as this 1.1 percentage point range of variation may appear to be, it amounts to nearly $5 billion of spending at current income levels, a not inconsiderable amount relative to the size of other potential influences on the magnitude of changes in GNP.

The consumption ratio fell in the second quarter to 91.8 per cent, about 0.5 percentage point under the low end of the recent range and the lowest value recorded for this ratio since the third quarter of 1958. In dollar terms, if the consumption ratio in the second quarter had fallen merely to the low end of the recent range, instead of to the still lower value actually recorded, $2 billion (on an annual rate basis) would have been directly added to the $6 billion increase that actually took place.

Since personal saving as measured in the national income accounts is simply the difference between disposable income and estimated consumer spending on goods and services, the apparent fall in the consumption ratio during the second quarter had as its counterpart a rise in the ratio of current saving to income. In other words, it thus appears that a relatively large proportion of the initial effect of the tax cut has been on saving. A rise in saving may take the form of a stepped-up rate of acquisitions by consumers of financial assets or repayments of outstanding indebtedness, or both. Data from the national income accounts showing a rise in the saving ratio in the April-June period are thus consistent with evidence of some increase in the rate of consumer debt repayments. (Credit extensions to consumers also rose somewhat, but growth in credit outstanding was below the first-quarter rate.) In addition, a substantial rise in the volume of new securities issues during the quarter—highlighted by the $1.2 billion American Telephone and Telegraph issue of common stock—may have absorbed some of the increased saving.

It must be remembered, however, that even a substantial rise in current saving, when spread out over the many forms which it can take, is unlikely to cause dramatic movements in specific financial series. Moreover, increases in holdings of particular financial assets may reflect shifts in the forms in which existing wealth is held as well as net additions to wealth through current saving. For these reasons, attempts to associate changes in holdings of any specific type of financial asset with a rise in saving stemming from the tax cut should be viewed with some degree of skepticism.

The tendency for the ratio of current saving to disposable income to rise when disposable income shows the sort of very rapid advance experienced in the second quarter has historical precedents. Indeed, the hypothesis that consumers respond to changes in their income with some lag has been supported by a number of econometric studies.[4] For a variety of reasons, many consumer purchases, particularly in the service component, can be expected to respond only very slowly to increased income. Thus, outlays on rent and interest charges on debt reflect decisions made in the past, while medical and legal expenses are not closely related to income. Moreover, a

[4] See, for example, Albert Ando and E. Carey Brown, "Lags in Fiscal Policy", in the Commission on Money and Credit's volume of papers, *Stabilization Policies*, 1963, pages 97-163.

significant portion of spending on nondurable commodities, particularly food, probably reflects long-established habits, and thus such expenditures too are not likely to show sharp variations as income moves ahead. Nevertheless, the increases in disposable income stemming from the tax cut can certainly be expected to exert long-run support to consumer spending, and some recovery in the consumption ratio would seem to be a reasonable expectation. Consumer buying plans remain strong, and record levels of expenditures on durables, the most volatile component of the consumer budget, indicate a continued willingness to spend.

The Money Market in July

The money market remained generally firm in July, though there were some variations in tone during the period which reflected mainly changes in reserve pressures on banks in the money centers. The market handled with facility the heavy financial flows associated first with the movements of currency around the Independence Day holiday period and later with the Treasury's advance refunding and repayment of maturing one-year bills. Substantial reserve pressures converged upon the major reserve city banks—especially during the second and third statement periods of the month—as these banks bore the brunt of the expanded financing needs of Government securities dealers that stemmed from the Treasury's massive advance refunding. For the most part, however, the money market banks were able to fill the bulk of their enlarged reserve needs in the Federal funds market, increasing only moderately their borrowings from the Federal Reserve Banks. Subsequently, there was a shift in reserves toward the money center banks, in part because of a decline in dealer financing needs, and the tone of the money market became somewhat more comfortable.

Against this background, Federal funds traded predominantly at 3½ per cent though there was some trading at lower rates on a number of days during the period when reserves shifted to the money centers. Similarly, rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were generally in a 3¾ to 3⅞ per cent range, although the rate dipped at times to 3⅝ per cent. Offering rates for new six- to nine-month time certificates of deposit issued by leading New York City banks ranged from 3.90 per cent to 4 per cent in July. The rates at which three- and six-month certificates of deposit traded in the secondary market tended to decline late in the month.

In early July, the major finance companies increased their offering rates on 30- to 89-day paper by ⅛ of a per cent. Later in the month, the finance companies made two downward adjustments of ⅛ of a per cent in their rates on 30- to 89-day paper and lowered their rates on 90- to 239-day paper by ⅛ of a per cent. Commercial paper dealers also reduced their offering rates by ⅛ of a per cent. Bankers' acceptances, with rates unchanged, attracted a strong demand, and dealers' portfolios declined sharply during the latter half of the month.

Treasury bill rates rose slightly at the beginning of the month. Subsequently, however, a considerable reinvestment demand for bills developed as a by-product of the Treasury's advance refunding operation and the pay-down of $2 billion of maturing July 15 bills, and rates moved lower through midmonth. In the latter part of July, a more cautious tone emerged in the bill market following the Treasury's announcement of the sale of a $1 billion "strip" of bills. Rates moved higher only briefly, however, and then steadied and edged lower once more.

The market for Government notes and bonds was dominated during the month by expectations of, and subsequent reactions to, Treasury financing operations. In the opening days of the period, prices of outstanding Government notes and bonds moved narrowly higher in quiet trading as the market awaited word of the Treasury's plans. Market reaction to the Treasury's July 8 refunding announcement was quite favorable, and lively trading ensued as investors adjusted their portfolios in response to the new investment opportunities presented by the complex exchange operation. Despite the considerable expansion in the market supply of intermediate- and long-term securities expected to result from the refunding, market participants remained confident in the outlook for general stability in interest rates. Contributing to the optimistic atmosphere in the bond market was the Treasury's statement that it did not contemplate any additional Government financing in the longer term maturity area during the remainder of the calendar year. After the close of the refunding subscription books on July 16, a more cautious tone emerged for a time in the market for outstanding notes and bonds, partly reflecting concern over the implications of the widening differentials between domestic and foreign interest rates. After a slight decline in prices, however, demand expanded somewhat and prices of outstanding notes and bonds generally moved higher during the remainder of the month, partly in favorable reaction to the Treasury's July 29 announcement of the terms of its $4 billion August refinancing. (For details, see below.)

In other sectors of the bond market, prices of corporate and tax-exempt bonds were little changed in early July. In the latter part of the month, corporate bond prices rose when demand expanded somewhat, while prices of tax-exempt bonds held generally steady.

BANK RESERVES

Market factors drained a net of $67 million in member bank reserves over the five weeks ended July 29. The bulk of these drains occurred in the first two weeks of the period, reflecting the usual contraction in float at the end of June as well as the movement of currency into circulation around the Independence Day holiday. In the week ended July 22, in contrast, float rose to its mid-month peak, currency flowed back into the banking system, and member bank required reserves declined, partly reflecting the redemption on July 15 of the last of the Treasury's quarterly series of one-year bills. Subsequently, as float fell off sharply toward the end of July, market factors again absorbed reserves.

These July fluctuations in market factors were offset on balance by the effects of System open market operations. Thus, System Account transactions released reserves in early July, absorbed reserves over the following two weeks, and again provided reserves in the final week of the period. Over the five-week period as a whole, the weekly average of System outright holdings of Government securities declined by $70 million, while average holdings of Government securities under repurchase agreements increased by $161 million. Average total System holdings of bankers' acceptances fell by $22 million. From Wednesday, June 24, through Wednesday, July 29, System holdings of Government securities maturing in less than one year rose by $281 million, while holdings maturing in more than one year remained unchanged.

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JULY 1964

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

Factor	Daily averages—week ended					Net changes
	July 1	July 8	July 15	July 22	July 29	
Operating transactions						
Treasury operations*	+ 21	+ 13	— 64	+ 100	+ 64	+ 134
Federal Reserve float	— 318	+ 64	— 95	+ 408	— 569	— 510
Currency in circulation	— 41	— 301	— 183	+ 130	+ 155	— 240
Gold and foreign account	— 1	+ 7	+ 11	— 8	— 2	+ 7
Other deposits, and other Federal Reserve accounts (net)†	+ 5	— 7	+ 51	+ 78	+ 11	+ 138
Total	— 335	— 222	— 280	+ 706	— 340	— 471
Direct Federal Reserve credit transactions						
Open market operations						
Purchases or sales‡						
Government securities	+ 396	+ 392	— 185	— 638	— 35	— 70
Bankers' acceptances	—	— 2	— 1	— 4	— 2	— 9
Repurchase agreements						
Government securities	+ 18	+ 102	+ 154	— 274	+ 161	+ 161
Bankers' acceptances	— 1	+ 31	— 22	— 39	+ 18	— 13
Member bank borrowings	— 11	+ 42	+ 197	— 301	+ 20	— 53
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+ 403	+ 564	+ 143	—1,255	+ 161	+ 16
Member bank reserves						
With Federal Reserve Banks	+ 68	+ 342	— 137	— 549	— 179	— 455
Cash allowed as reserves§	+ 50	— 382	+ 325	— 14	+ 66	+ 45
Total reserves§	+ 118	— 40	+ 188	— 563	— 113	— 410
Effect of change in required reserves§	— 67	— 71	+ 93	+ 268	+ 136	+ 359
Excess reserves§	+ 51	— 111	+ 281	— 295	+ 23	— 51
Daily average level of member bank:						
Borrowings from Reserve Banks	221	263	460	159	179	256‖
Excess reserves§	402	291	572	277	300	368‖
Free reserves§	181	28	112	118	121	112‖

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ May also include redemptions.
§ These figures are estimated.
‖ Average for five weeks ended July 29, 1964.

THE GOVERNMENT SECURITIES MARKET

In the market for Government notes and bonds, prices of most outstanding issues edged irregularly higher at the beginning of July. A moderate investment demand favoring the 2½ per cent wartime issues was in evidence; however, activity tended to be restrained, as participants awaited announcement of the Treasury's July financing plans. Although uncertainty prevailed over the nature of a possible debt operation in July, confidence remained high in the underlying near-term stability of interest rates.

After the close of business on July 8, the Treasury announced that the further improvement of its cash position made unnecessary any immediate substantial cash borrowing. At the same time, the Treasury disclosed the terms of the largest advance refunding offer it had ever made. Holders of approximately $42 billion of nine selected note and bond issues maturing from August 1964 through February 1967 were given an opportunity to exchange their holdings for additional amounts of the outstanding 4 per cent bonds of October 1969, for new 4⅛ per cent bonds of November 1973, or for reopened 4¼ per cent bonds of August 1987-92. The outstanding issues eligible for conversion—$26.6 billion of which was publicly held—were the 5 per cent and 3¾ per cent notes of August 1964, the 4⅞ per cent and 3¾ per cent notes of November 1964, the 3⅞ per cent notes of May 1965, the 3⅝ per cent notes of February 1966, the 3¾ per cent bonds of May 1966, the 4 per cent notes of August 1966, and the 3⅝ per cent notes of February 1967. Subscription books were open from July 13 through July 16, with the actual exchange taking place on July 24.

The market greeted the Treasury's July 8 advance refunding offer with considerable enthusiasm. Activity expanded sharply, as news of the operation triggered heavy trading in the issues directly involved in the exchange as well as extensive switching transactions in other Government securities. A broad professional and investment demand quickly developed for the refunding "rights" and pushed prices of those issues as much as $^{6}/_{32}$ higher in early trading. Subsequently, however, these price gains were pared as a heavy volume of rights offerings gradually satiated the spirited demand for them.

Prices of outstanding high coupon securities maturing beyond 1969 adjusted $^{5}/_{32}$ to $^{18}/_{32}$ lower after the refunding announcement, reflecting both the potential addition to debt in this area and the immediate increase in market supplies of such maturities as a result of switching into the "when-issued" refunding securities. At the same time, prices of those short-term coupon issues that were not rights moved higher, largely in response to reinvestment demand from sellers of rights; interest in the popular 2½ per cent wartime issues remained strong. With the conclusion of the refunding subscription period on July 16, activity tapered off while the market awaited the results of the operation.

A slightly hesitant tone developed briefly in the Government securities market, following the closing of the books, as the widening spread between interest rates here and abroad generated some apprehension. However, the bond market took in stride the July 20 announcement that early reports indicated a refunding exchange of about $9 billion, implying larger additions to the supplies of intermediate and longer term maturities than most participants had expected. Details of the exchange, released on July 21, indicated a highly successful operation for the Treasury. Subscriptions from the public totaled $9.3 billion—or 34.7 per cent of their eligible holdings. Public holders subscribed for approximately $3.7 billion of the reopened 4 per cent bonds of 1969, $4.4 billion of the new 4⅛ per cent bonds of 1973, and $1.2 billion of the reopened 4¼ per cent bonds of 1987-92. Subscriptions from official accounts totaled $26 million.

From July 21 through the end of the month, prices were generally steady, as fairly good investment demand enabled dealers to make some progress in redistributing issues acquired in the advance refunding. The market reacted favorably to the terms of the Treasury's August refunding, announced after the close of business on July 29. In replacement of $1.2 billion of the 5 per cent notes and $2.9 billion of the 3¾ per cent notes maturing on August 15, the Treasury offered about $4 billion of new eighteen-month 3⅞ per cent notes, priced at par, for cash subscription. Books were to be open only on August 3 for the new notes, which will be dated August 15, 1964 and will mature on February 15, 1966. (At the same time, the Treasury announced plans to offer about $1 billion to $1½ billion of March tax bills later in August.)

In the Treasury bill market, offerings expanded somewhat and rates edged slightly higher through July 7. The increase in offerings reflected commercial bank selling of shorter maturities in a firm money market and sales of various maturities by investors seeking to make room in their portfolios for the delivery of new one-year bills on July 7. Subsequently, however, a good investment demand from public funds and other sources developed—especially for longer bill maturities—and a steady tone reappeared in the bill market. In addition, the Treasury disclosed, in conjunction with its July 8 refunding announcement, that its immediate cash needs were much smaller than had been anticipated and that it would, for the time being, confine its cash borrowings to increases in the weekly bill issue. The bill sector was encouraged by this news. Following the advance refunding announcement, demand—particularly for longer bill maturities—expanded sharply, as sellers of refunding rights reinvested the proceeds both in outstanding coupon issues and in Treasury bills. Considerable demand for the scarce shorter maturity bills also arose from the reinvestment of a portion of the proceeds of $2 billion of one-year bills which matured on July 15. Against this background, bill rates generally receded from July 9 through midmonth. A more cautious atmosphere emerged in the bill market in the latter part of the month, however, as participants began to question the viability of prevailing bill rate levels in view of the growing gap between short-term money market rates abroad and the lower rates prevailing in this country. This caution was reinforced by the

Treasury's announcement that it would auction on July 24 a $1 billion strip of bills for payment on July 29, representing additions of $100 million to each of ten of the outstanding weekly bill issues maturing from October 15 through December 17, 1964. (Commercial banks were not permitted to pay for the bills through credit to Treasury Tax and Loan Accounts.) Market observers regarded the strip offering as indicative of an official desire for higher bill rates, and rates on outstanding bills generally rose 2 to 4 basis points following the strip announcement. Subsequently, rates steadied and edged lower again from July 22 through the month end, as continued investment demand—particularly for the shorter maturities—pressed against a thin market supply of bills. Over the month as a whole, rates on most outstanding short-term bills were 1 to 12 basis points lower, while long-term bills were generally 5 basis points lower to 5 basis points higher.

An average issuing rate of 3.505 per cent was set at the strip bill auction on July 24. At the last regular weekly auction of the month held on July 27, average issuing rates were 3.475 per cent for the new three-month issue and 3.591 per cent for the new six-month bill, virtually unchanged and 6 basis points higher, respectively, than the average rates at the final weekly auction in June. The July 30 auction of $1 billion of new one-year bills resulted in an average issuing rate of 3.644 per cent, compared with an average issuing rate of 3.691 per cent on the comparable issue sold in June. The newest outstanding three-month bill closed the month at 3.47 per cent (bid), as against 3.48 per cent at the end of June, while the newest outstanding six-month bill was quoted at 3.57 per cent (bid) on July 31, compared with 3.52 per cent at the close of the preceding month.

OTHER SECURITIES MARKETS

Prices of seasoned corporate and tax-exempt bonds were unchanged to a shade higher in the early part of the month. Market activity was somewhat restrained as participants first awaited, and then assessed, the implications of the Treasury's advance refunding operation for the corporate and tax-exempt markets. A moderate revival in demand for recent flotations still bound by syndicate price restrictions developed after aggressive bidding by underwriters had pushed reoffering yields on new issues in both sectors down somewhat. Investor interest in these new issues was selective, however, at the higher price levels.

In the latter part of the month the tone of the corporate sector strengthened, in response to expanded demand from institutional investors and a slackening calendar of scheduled flotations. In the tax-exempt sector, however, where a heavier than seasonal volume of new issues continued to reach the market, prices remained generally steady. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds was unchanged at 4.40 per cent, while the average yield on similarly rated tax-exempt bonds declined by 2 basis points to 3.09 per cent. (These indexes are based on only a limited number of issues.)

The volume of new corporate bonds floated in July amounted to approximately $230 million, compared with $460 million in the preceding month and $345 million in July 1963. The largest new corporate bond issue publicly marketed during the month consisted of $60 million of unrated 4½ per cent debentures maturing in 1989. The debentures, which carry five-year call protection, were offered to yield 4.60 per cent and were well received. New tax-exempt flotations in July totaled approximately $835 million, as against $780 million in June 1964 and $800 million in July 1963. The Blue List of tax-exempt securities advertised for sale closed the month at $725 million, compared with $595 million on June 30. The largest new tax-exempt bond issue during the period consisted of $123 million of A-rated various purpose municipal bonds. Reoffered to yield from 2.30 per cent in 1966 to 3.50 per cent in 1995, the bonds were accorded a good investor reception. Other new corporate and tax-exempt issues floated in July met with mixed investor receptions.

The Report of the Canadian Royal Commission on Banking and Finance: A Review

By FRANCIS H. SCHOTT*

A Canadian Royal Commission appointed by the Canadian Government in 1961 "to inquire into and report upon the structure and methods of operation of the Canadian financial system" and to make recommendations regarding possible changes has recently submitted its Report.[1] Under the chairmanship of Chief Justice Dana Porter of Ontario[2] and assisted by an able staff, the Commission spent two and one-half years in preparing the first comprehensive survey of Canada's financial system since the Macmillan Report of the early 1930's (which led to the establishment of the Bank of Canada in 1934). The Commission held sixty-nine days of public hearings in eleven centers across Canada, received and evaluated 110 briefs from interested parties—including a number of papers solicited from distinguished foreign central bankers and economists—and undertook extensive research of its own.[3]

The resulting document is worthy of the attention of students of central banking and of monetary theory and practice everywhere. Due to the Commission's pragmatic yet thorough and scholarly approach, the Report constitutes a valuable case history of the evolution of a modern financial system and as such makes a contribution that is likely to be lasting. In complying with its terms of reference, however, the Commission did not stop at description and evaluation. In a series of important recommendations, it proposes corrective measures for regulatory and institutional lags it believes it has found. And the philosophy underlying these recommendations, regardless of whether one agrees with all of them, is appealing. Monetary and banking regulation there must be, the authors say, but

> We have favored a more open and competitive banking system—carefully and equitably regulated under uniform legislation, but not bound by restrictions which impede the response of institutions to new situations (p. 564).

Because of the close economic and financial ties between Canada and the United States, the Report is of special interest in this country. The Commission's analysis and recommendations are in fact likely to exert a considerable, although probably only a gradual, influence on future Canadian-United States financial relations. This review, which must necessarily be highly selective, therefore places emphasis on matters of special interest to United States readers.

BANKING STRUCTURE

The possible need for structural reform in the regulation of Canada's financial institutions attracted the Commission's closest attention. The Commission was aware of the opportunity for reform afforded by the statutory decennial Parliamentary renewal of Canada's basic Federal Bank Act during 1964. The Commission was, furthermore, impressed by the rapid growth over the past decades in the types and numbers of institutions competing with the present eight chartered banks both as lenders of funds and as issuers of highly liquid short-term

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[1] *Report of the Royal Commission on Banking and Finance* (Ottawa, Canada: The Queen's Printer, 1964), 587 pages.

[2] The other members of the Commission were W. Thomas Brown of Vancouver, investment dealer; James D. Gibson of Toronto, commercial banker; Gordon L. Harrold of Calgary, farmer; Paul H. Leman of Montreal, corporation executive; John C. MacKeen of Halifax, public utility executive; and Dr. W. A. Mackintosh of Kingston, university executive.

[3] The foreign central bankers who submitted papers and testified at the request of the Commission included Governor Holtrop of the Netherlands Bank, Lord Cobbold, former governor of the Bank of England, and Allan Sproul, former president of the Federal Reserve Bank of New York. Non-Canadian economists assisting the Commission in a similar fashion included, among others, Erik Lundberg, Paul Samuelson, Woodlief Thomas, and Jacob Viner.

claims; and it noted that the commercial banks had been losing ground to their competitors in terms of their share in both assets and liabilities of the financial system.

The mixing of functions does indeed appear to have gone very far in Canada. As regards lending, for example, the chartered banks have expanded their personal loan business so much that they are now the largest participants in a market in which sales finance companies had pioneered; but the finance companies have meanwhile greatly expanded their medium-term business financing since the chartered banks have not been very active in term lending. Another example is that the chartered banks—excluded from the conventional mortgage field, which is handled largely by the mortgage loan and the trust companies—have nevertheless been able to acquire a substantial mortgage portfolio through the exemption granted in the case of mortgages insured under the National Housing Act (NHA), although this portfolio has not been expanding for several years.[4]

It is striking that, in the Commission's view, the customary distinction between money and near money is not so meaningful as it is sometimes considered to be, either in terms of the institutions or of the instruments usually associated with each of these two categories. Savings deposits in chartered banks are in practice subject to transfer by check. The same is true of deposits in the two Quebec savings banks and of deposits in credit unions which, together with their equivalent in the French-speaking sections of Canada, constitute an especially fast-growing part of the financial structure. Moreover, both the mortgage loan and the trust companies accept demand deposits and savings deposits subject to transfer by check, besides issuing their own paper over a broad maturity range.

Against this background, the Commission questioned, first, whether the special restrictions placed upon institutions exercising a banking function—presently defined only by actual chartering under the Federal Bank Act—were still justified; and, second, whether other groups of institutions doing a closely similar business should continue to be permitted to operate partially under separate Federal, but largely only under Provincial, laws and regulations. In regard to the first of these questions, the Commission recommended that the chartered banks be relieved of the two most important of the special restrictions, namely the prohibition on taking non-NHA mortgages as security and the 6 per cent ceiling on their interest charges on loans in Canada.[5]

In answering the second and more basic question, the Commission took the view that nothing less than a functional definition of banking and equal regulatory treatment of all institutions falling within that definition would satisfy its standards of equity, competitiveness, and efficiency. The distinction between banks and nonbanks, the Commission says, should be drawn on the liabilities side; specifically, banking is the creation of "claims which serve as a means of payment or close substitutes for them" (p. 378). Therefore, the acceptance of

> term deposits, whatever their formal name, and other claims on institutions maturing, or redeemable at a fixed price, within 100 days of the time of the original issue or of the time at which notice of withdrawal is given by the customer (p. 378)

should, in the Commission's view, make the accepting institution one that is engaged in banking; and any such institution would have the choice of operating in accordance with Federal banking laws and thus becoming subject to chartered-bank regulations as revised or, alternatively, of getting out of the banking business (as newly defined).[6] The Commission does not deny that there is an element of arbitrariness in the proposed specific maturity range of liabilities the acceptance and issue of which would make an institution a bank. But it emphasizes that any shorter maturity would be unrealistic in view of the very close similarity of the various short-term instruments, while a longer maturity is not needed to achieve an "equitable, sound and uniform pattern of banking regulation" (p. 378).

The Commission does not hesitate to pursue this sweeping recommendation in terms of the required rearrangements of Canada's financial structure. Thus, institutions choosing to remain nonbanks would benefit from a removal of all restrictions on their portfolios related to their previous near-bank status; and those choosing to

[4] The Central Mortgage and Housing Administration, which administers the NHA, is similar to the United States Federal Housing Administration.

[5] As noted, the banks have been permitted to invest in mortgages guaranteed under the NHA, and, in the case of personal loans, service fees have added to the effective interest charge to the customer. Nevertheless, the two restrictions have had concrete effects, especially in limiting indirectly the chartered banks' ability to compete for deposits on a rate basis.

[6] A number of specific exceptions would, however, be made. One would be for institutions such as sales finance corporations which sell short-term claims upon themselves through independent investment dealers.

become full-fledged banks would acquire all corresponding rights. For example, the present mortgage loan and trust companies could, if they became banks, make personal and short-term business loans.

On the other hand, any institution taking out a bank charter would also become subject to all obligations attached to being a bank; and many of the present nonbanks —in fact, entire groups of institutions—would not have much choice but to become banks, given the present nature of their business. Among their new obligations, those bearing on cash reserve requirements would be of particular importance. At present, only the chartered banks and the Quebec savings banks are subject to specified cash reserve requirements, which for the chartered banks amount to 8 per cent against all deposits. Other institutions hold cash reserves as they deem necessary for the conduct of their business, with actual ratios tending to be somewhat, although not drastically, lower than those of the chartered banks.

The Commission recommends that all banks (as newly defined) be required to maintain cash reserves of 8 per cent on deposits repayable on demand or on notice of up to seven days, and of 4 per cent on all other deposits repayable on notice of up to one year, with strict enforcement of the distinction between the two types of deposits. This would mean that the average effective reserve requirements for chartered banks would drop slightly while many of the present nonbanks would be required to hold a higher level of cash reserves than is their current practice, although the Commission would permit a few concessions. The chartered banks, however, would lose the deposits of present nonbank financial institutions holding their reserves with them should these institutions choose to take out bank charters. The Commission can see no reason why uniform regulation, for which it strives, should not also mean that all banks would hold their required reserves with the central bank, and it therefore submits that recommendation.[7]

[7] The Commission also suggests dropping the liquid-asset ratio (cash plus highly liquid assets must equal 15 per cent of deposit liabilities) which the chartered banks have maintained since 1955 under an agreement with the Bank of Canada; the Commission would be willing to grant the Bank of Canada stand-by powers to impose (and vary) such a ratio to achieve monetary policy objectives. From a supervisory point of view, the Commission does not consider such a liquidity requirement necessary. The chartered banks have generally maintained ratios substantially higher than 15 per cent in order to meet their liquidity needs as judged by themselves; and the actual needs of different institutions will vary with the nature of their other assets and liabilities. The Commission expresses the hope, however, that the institutions concerned will "support wise supervision in a matter which bears so directly on their own best interests" (p. 395).

INTERNATIONAL FINANCIAL RELATIONS

The Commission considers both broad questions of international financial policy and those relating to banking relationships between Canada and the United States. Given the fact that Canada returned to a fixed exchange parity only in 1962 (during the Commission's study) after a twelve-year experience with a fluctuating exchange rate, the Commission naturally gives special attention to the type of exchange rate system and the level of the exchange rate appropriate for Canada. The Commission evaluates the main claim made for a fluctuating rate— that it confers a greater degree of freedom upon domestic monetary and fiscal policy than does a fixed-rate system —and arrives at the judgment that in practice the claim has limited merit. It therefore concludes firmly that

> in our view the existing parity of 92½¢ U.S. is a good exchange rate for Canada and one which we hope can be maintained for a long time to come. . . . Our financial policies, particularly our monetary and debt policies, should never be carried out without regard to their international consequences and a fixed exchange rate will help to ensure that this is the case (p. 503).

The Commission also takes note of the current official international studies of the world's payments system, which have focused on the question of international liquidity, and comments

> that it is in the interests of this country [Canada] that, with appropriate safeguards against irresponsible borrowing, international reserves should be gradually increased so that time will be available to national financial authorities to make adjustments to their international positions while at the same time retaining some freedom of action to pursue domestic objectives of policy (p. 502).

In this connection, the Commission endorses the network of inter-central bank currency arrangements (swaps) that have been developed in the last few years. Such arrangements are

> . . . now temporary expedients, but if the "temporary" period is long enough, and if the facilities are put on a regular basis and the amounts involved are large enough, a considerable step has been taken to provide time for more fundamental adjustments to take place (p. 502).

As regards international banking relationships, the Commission observes that agencies of Canadian banks now do a very extensive business in New York and that branches and agencies of these banks are very active in many other countries. Careful consideration was therefore given to the possible granting of certain reciprocal rights in Canada, and the Commission recommends that Canadian law explicitly provide for the establishment of foreign bank agencies, which would be empowered to do most types of banking business except for receiving deposits. (There are now some representative offices, but no foreign bank agencies, in Canada.) The Commission would insist, however, upon specific Canadian Treasury Board approval of all acquisitions of shares of Canadian banks by foreign banking interests since it believes that "a high degree of Canadian ownership of financial institutions is in itself healthy and desirable" (p. 374).[8]

In examining the present foreign activities of Canadian banks, the Commission notes that the foreign-currency business of these banks, in particular, has grown enormously. Between 1954 and 1962, the chartered banks' foreign assets increased (in Canadian dollar equivalents) by $2.8 billion, or almost 250 per cent, as against a roughly 60 per cent growth of domestic assets; and foreign-currency deposits, at roughly $4 billion (end-of-1962 figure), exceeded one fifth of total deposits. The Commission holds, however, that this growth generally has not influenced internal Canadian credit conditions heavily and therefore has not vitiated the effectiveness of domestic monetary policy. The banks generally maintain balanced exchange positions on an over-all basis spot and forward combined (i.e., match their foreign-currency liabilities with foreign-currency assets); however, the Commission acknowledges that the banks' spot balances in foreign exchange have at times been reduced to generate additional Canadian dollar funds and that doing so has helped the banks to get through periods of especially tight domestic liquidity conditions.

The Commission thus regards additional controls in this area as unnecessary, but it does issue two explicit warnings. One of these relates to the banks' willingness to accept short-term Canadian-dollar deposits and denominate them at their foreign-currency equivalent through a corresponding foreign exchange transaction. Should the banks ever abandon on a significant scale their present practice of covering these deposits by corresponding short-term foreign-currency assets, it might be necessary to remove the present exemption of such deposits from cash reserve requirements. The second warning relates to the need for liquidity of the banks' foreign-currency assets in general. The Commission notes that the chartered banks are a factor of considerable significance in the Euro-dollar market and (through their agencies) in the New York call loan market.[9] A high degree of liquidity is currently being maintained: only 34 per cent of foreign-currency assets was in other than call loan form at the end of 1962. Should these liquidity standards be relaxed by the banks, however, official liquidity ratios on the banks' exchange position might have to be imposed.

THE EFFECTIVENESS OF MONETARY POLICY

The Commission submits both the instruments and the effectiveness of monetary policy to a searching analysis. Its contribution in the second of these areas is especially significant, since the Commission made detailed studies of its own in seeking to ascertain the degree and timing of the economy's response to changes in monetary policy. Thus, the Commission's staff interviewed eighty firms, which account for over one half of total corporate capital expenditures, and sampled the rest of Canada's corporations to find out how these users of funds were affected by variations in credit conditions. Sample surveys were also made of local governments and of households; and the Commission supplemented this technique with econometric analysis designed to isolate the effect of monetary policy on a sector-by-sector basis. As a result of these studies, the Commission endorses the effectiveness of monetary policy, through its influence on general credit conditions, as an instrument for moderating fluctuations in aggregate economic activity—but this endorsement is subject to some qualifications.

These qualifications, it might be noted, do not involve two points that have been brought up in some recent questioning of the effectiveness of monetary policy in the United States. As regards one of these points, the Commission does not believe that monetary policy has been vitiated by the rise of near banks and of financial intermediaries in general, rapid though that rise has been. Its recommendations in this area, as has been pointed out,

[8] There already exists a requirement that any new bank, whether established by foreigners or by Canadians, obtain a charter from Parliament. The Commission would leave undisturbed foreign control of the smallest and newest chartered bank, which was founded by foreign interests in 1953.

[9] The Canadian bank agencies, as pointed out by the Commission, have occasionally accounted for about one half of all call loans to New York securities dealers.

are based primarily on grounds of equity. The Commission recognizes that financial intermediaries can affect the velocity of money—and, at the same time, the rate of credit expansion of the financial system as a whole—even without central bank-induced variations in the system's cash base. But the Commission holds that the intermediaries' operations tend to bear a fairly stable relationship to those of the banks and hence can be compensated for by the central bank. With respect to another point recently raised in the United States, the Commission gives no support to the view that monetary policy might be impaired by any inability—whether or not it exists—to control directly such factors as the money supply which, unlike bank reserves, are affected only "at one remove" by central bank operations. On the contrary, the Commission emphasizes that Bank of Canada action on bank reserves and other measures at the central bank's disposal should seek to, and in fact do, influence credit cost, terms, and availability over a wide spectrum.

The Commission's doubts thus are of a different nature, relating primarily to potential limitations upon the effects on aggregate economic activity of monetary policy changes, if applied in moderate doses; and to the possibility that such effects as do occur may show up only after a significant time lag, which implies that the impact of policy might be inappropriate in terms of stabilization requirements at the time it actually takes place. The Commission goes on, however, to emphasize the important role it does in fact see for monetary policy. Thus, some degree of responsiveness of expenditures to changes in credit conditions was found in numerous sectors of the economy, most clearly during periods of monetary restraint; and the aggregate response was sufficient to convince the Commission that the effects of monetary policy "are significant enough to be worth striving to achieve at the right time" (p. 444). Furthermore, in the case of very substantial changes in credit conditions, the response in terms of expenditure decisions was considerably more discernible and rapid than in the more general case of gradual changes; and, quite apart from its potential for influencing the domestic economy, monetary policy had proved of indubitable effectiveness over the past years in maintaining or restoring international payments equilibrium.

On balance, the Commission's doubts were sufficient to lead it to emphasize very strongly the need for coordinated fiscal and monetary policies in achieving over-all stabilization objectives. In this connection, the Commission endorses Governor Rasminsky's suggestion for a "directive" procedure in resolving Government-central bank disputes—i.e., a method whereby in a deadlock the Government would give the Bank explicit, written, and binding policy instructions for temporary periods. This recommendation is accompanied by expressions of hope that the procedure will never be utilized.

REGULATORY EQUITY: A COMPARISON OF THE CANADIAN AND TWO UNITED STATES REPORTS

The issue of regulatory equity in the treatment of competing groups of financial institutions, which is so prominent in the Canadian Royal Commission Report, has also received considerable attention in two recent United States reports—those of the privately sponsored Commission on Money and Credit (CMC) and of the official President's Committee on Financial Institutions (the Heller Committee).[10] Both of these reports recognized, as does the Canadian Report, that financial evolution can lead to a considerable overlapping of functions among groups of institutions that might have started with distinct objectives and hence with distinct legal rights and obligations; and both of the United States reports also made corrective recommendations. Hence, parallels with the Canadian Royal Commission Report can be drawn, although significant differences do of course exist among the three reports.

To recall only some of the reforms suggested primarily for equity reasons in the United States reports: both groups recommended measures (although not the same ones in the two cases) to put banks that are not members of the Federal Reserve System on a more nearly equal footing with member banks;[11] and both groups sought to place commercial banks in a position to compete on even terms with other types of institutions for time and savings deposits. The Heller Committee recommended introduction of a cash reserve requirement for shares at savings and loan associations and for deposits at mutual savings banks identical to the commercial bank time deposit requirement; and the CMC would equalize relative positions by repealing reserve requirements against time and savings instruments no matter where held. The CMC also recom-

[10] See "Money and Credit—Their Influence on Jobs, Prices and Growth", *The Report of the Commission on Money and Credit* (Englewood Cliffs, New Jersey: Prentice Hall, 1961); and *Report of the Committee on Financial Institutions to the President of the United States* (Washington, D.C.: United States Government Printing Office, 1963).

[11] The CMC would require all banks using Federal Deposit Insurance Corporation facilities to become Federal Reserve System members; the Heller Committee suggests that all commercial banks be subject to System cash reserve requirements and have access to the Federal Reserve discount window, while leaving System membership optional for state-chartered banks.

mended that commercial banks (in the investment of their time and savings deposits), savings banks, and savings and loan associations should all enjoy the least burdensome restriction which is commonly available to any of them. Furthermore, both groups recommended equalization of time and savings deposit interest-rate regulations for all institutions and the placing of such controls on a stand-by basis.

Important as these recommendations are in the United States context, however, they clearly represent even in combination a considerably more gradual approach to reform than that adopted by the Canadian Royal Commission. This does not necessarily mean, however, that the equity criterion was given less attention in the United States reports. The difference in the respective sets of recommendations can be traced at least partly to differences in underlying circumstances. In particular, important groups of nonbanks have more closely stuck to their original specialized purposes in the United States than similar groups have done in Canada. All three reports are agreed, however, in urging public and legislative consideration of the problems arising from the structure of financial institutions with a view to adapting the regulatory machinery to current economic and financial conditions and to facilitating efficient and rapid response to further evolution.

Fiftieth Anniversary of the Federal Reserve System— Organization and First Actions of the Board*

Many important Washington figures gathered in the office of the Secretary of the Treasury on Monday morning, August 10, 1914, to witness the swearing-in of the new Federal Reserve Board. It must have been a solemn occasion. War had broken out in Europe the previous week, bringing with it great uncertainty and perplexing financial problems.

The men who were to confront these problems had come to Washington from different backgrounds and regions. The Federal Reserve Act had specified that no two of the five men appointed by the President could come from the same Federal Reserve District and that two should be experienced in banking or finance. The new body was to exercise general supervision over the Federal Reserve Banks.

President Wilson had spent several months making the selections, and the Senate did not confirm all the appointments until the end of July. Charles S. Hamlin, a Boston lawyer who was then serving as an Assistant Secretary of the Treasury, was designated Governor of the Board (equivalent to the present Chairman). The Vice Governor (Vice Chairman) was to be Frederick A. Delano, a railroad executive from Chicago. Paul M. Warburg, a member of a New York banking firm, and W. P. G. Harding, president of a national bank in Birmingham, Alabama, were selected as the members with banking or financial experience. The fifth appointee was A. C. Miller, a former professor of economics at the University of California, who was serving as Assistant to the Secretary of the Interior.

Under the new law the Secretary of the Treasury and the Comptroller of the Currency were ex-officio members. Thus, Secretary William Gibbs McAdoo and John Skelton Williams completed the "Supreme Court of Finance", as the Board was informally called. (The Federal Reserve Act was amended in 1935, removing the provision for ex-officio membership, making all seven positions appointive, and changing the official title to the Board of Governors of the Federal Reserve System.)

When the members of the new Board assembled for their first meeting the Thursday after being sworn in, they had to make a choice between immediately completing the organization of the Reserve Banks or developing emergency programs to counteract the financial

* The eighth in a series of historical vignettes appearing during the System's anniversary year. For more detailed information, the reader may wish to refer to *The Federal Reserve System*, by Henry Parker Willis, and *The Formative Period of the Federal Reserve System*, by W. P. G. Harding, from which the material in this article is largely drawn.

disturbances caused by the war. The latter course was adopted, resulting in the establishment of a gold pool and a cotton loan fund.

One of the earliest and most trying financial consequences of the war was a highly abnormal condition in the foreign exchange market. The balance-of-payments position was deteriorating seriously in August 1914, with both the trade and capital accounts contributing to a large deficit. Exports declined sharply because of the disorganization of ocean shipping and the virtual collapse of European credit markets, the usual source for United States export financing. At the same time Europeans were dumping holdings of American securities in the New York market, and a large amount of American obligations held by foreigners was scheduled to mature in the near future. Discussing this situation, the first *Annual Report* of the Federal Reserve Board observed: "The securities markets were badly demoralized, prices fell with alarming rapidity, and the country was exposed to a serious and disastrous drain of gold."

In response to this problem the Federal Reserve Board took the initiative in calling a conference of private bankers to discuss emergency action. The larger banks throughout the country agreed to subscribe $100 million to a gold pool, which could be used to settle American debts to Europe and thus help restore confidence in the dollar.

In addition, a very serious problem confronted the cotton-producing states. Since 60 per cent of American cotton production was normally exported, interruption of Atlantic shipping and the closing of the United States and British cotton exchanges resulted in a major financial crisis in the South. Cotton exporters needed credit to finance their higher-than-normal inventories, but Southern banks were already overextended. To provide relief, the major banks in the North, cooperating with the Federal Reserve Board, agreed to establish a $100 million cotton loan fund, from which credit could be made available to the cotton exporters.

Operations actually required under the gold exchange fund were small, and under the cotton loan fund virtually zero. However, the two plans had a highly beneficial psychological impact. Thus, even before the Reserve Banks opened, the new System had demonstrated its usefulness to the country.

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2. THE MONEY SIDE OF "THE STREET" (1959) by Carl H. Madden. A 104-page booklet giving a layman's account of the workings of the New York money market and seeking to convey an understanding of the functions and usefulness of the short-term wholesale money market and of its role in the operations of the Federal Reserve. 70 cents per copy.

3. FEDERAL RESERVE OPERATIONS IN THE MONEY AND GOVERNMENT SECURITIES MARKETS (1956) by Robert V. Roosa. A 105-page booklet describing how Federal Reserve operations are conducted through the Trading Desk in execution of the directions of the Federal Open Market Committee. Discusses the interrelation of short-term technical and long-range policy factors in day-to-day operations. Has sections on the role of the national money market, its instruments and institutions, trading procedures in the Government securities market, what the Trading Desk does, the use of projections and the "feel" of the market, and operating liaison with the Federal Open Market Committee.

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5. DEPOSIT VELOCITY AND ITS SIGNIFICANCE (1959) by George Garvy. An 88-page booklet discussing the behavior of deposit velocity, over the business cycle and over long periods, with emphasis on the institutional and structural forces determining its behavior. 60 cents per copy.

INTERNATIONAL ECONOMICS

6. MONETARY POLICY UNDER THE INTERNATIONAL GOLD STANDARD, 1880-1914 (1959) by Arthur I. Bloomfield. A 62-page booklet analyzing, in the light of current monetary and banking theory, the performance and policies of central banks within the framework of the pre-1914 gold standard. 50 cents per copy.

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