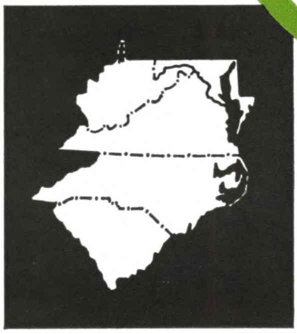
FEDERAL RESERVE BANK OF RICHMOND

MONTHLY REVIEW

The Role of Monetary Policy
Stock Exchange Membership
United States Foreign Assistance
The Fifth District



MAY 1969

The Role of Monetary Policy

Over the past two decades, there has developed in the United States a rather general consensus that the proper objectives of economic policy include the fostering of a low rate of unemployment, a high and stable rate of economic growth, reasonable stability in the purchasing power of the dollar, and the protection of the external value of the dollar. Although the importance of a particular objective may vary over time, there is still general agreement that all of these are appropriate policy goals.

There has been less agreement as to the policy tools to be used in achieving these objectives. At the end of World War II, monetary policy was held in low esteem by many economic policymakers and academic economists. The Keynesian economics that developed during the Great Depression emphasized the impotence of monetary policy and the efficacy of fiscal policy, a position that was accepted by most economists. By and large, monetary policy was assigned the task of keeping interest rates low, while fiscal policy was to be used to offset disequilibrating swings in private investment.

As it became apparent that inflation, not stagnation or recession, was to be the foremost economic problem in the postwar period, policymakers with some reluctance began to accord monetary policy a more important role in the task of economic stabilization. In the United States, the outbreak of the Korean War contributed to the urgency of this problem. A significant milestone in the growing importance of monetary policy was the Treasury-Federal Reserve Accord of 1951, which relieved the Federal Reserve System of the necessity of pegging interest rates. Academic economists were generally slower to recognize the importance of money, but they, too, did so in time, and it is perhaps fair to say that today most economists accord money and monetary policy a significant role in the efforts to achieve economic stability and growth. There is reason to believe, however, that the pendulum might have swung too far. Economists who fifteen years ago were trying to convince the Keynesians that money did matter, now find themselves trying to convince the New Quantity Theorists that money is not the only thing that matters.

Serious shortcomings in fiscal policy in recent years contributed importantly to the recent over-emphasis on the role of money. Only a few years ago, much was being written about what was called the "New Economics," an important element of which was the use of fiscal policy to "fine tune" the economy. But since 1965, failure to provide adequate financing for the Viet Nam War and a host of new social programs have created serious inflationary pressures and ended talk of fine tuning. Failure of the long overdue fiscal action of 1968 to halt inflation added to the zeal of the more militant among the New Quantity Theorists and, what may be more important, it convinced a number of politicians and newspaper writers and editors that the critics of fiscal policy had been right all along.

The recent controversy has raised questions not only as to the relative merits of monetary and fiscal policies, but also as to the appropriate guidelines for monetary policy. One proposal that has received consideration is that the rate of growth in the money supply should be the only guide to monetary policy. This article will attempt briefly to describe some of the assumptions underlying the rule and to indicate some problems that might arise from its adoption.

Basic to the proposal is the idea of a direct relationship between changes in the money supply and the level of economic activity. While proponents of this approach do not say that changes in the money supply are the *only* factors affecting economic activity, they do use such terms as "major determinant of short-run movements in total spending," and "the dominant factor . . . ." In like manner, the more careful among them admit that their empirical investigations do not show any necessary *causal* relationship between money and total spending, but when the discussion gets around to policy they all act *as if* such a relationship did exist.

Granted the assumption of a direct link between changes in the money supply and the level of economic activity, the proper policy prescription would seem to be to control changes in money so as to bring about the desired level of activity. But adherents of the money supply school maintain that the time lag between monetary actions and economic reactions is long and variable, and economic forecasting techniques are imperfect. Thus, in their view, attempts to stabilize the economy by discretionary changes in the growth rate of money are doomed to failure and may even accentuate the instability of the economy. The best monetary policy, therefore, is one which results in a growth in the money stock at some steady rate, perhaps one equal to the real economic growth rate. They acknowledge that such a policy will result in some instability, but contend that the degree of instability will be less than it would be if a discretionary monetary policy is followed.

There has been much discussion and controversy among economists with respect to the theoretical and statistical analyses underlying these views. Almost all economists agree that there is a relationship between changes in the money stock and economic activity, but a majority argue that it is much less direct and predictable than the New Quantity Theorists claim. Many question the statistical techniques that have been employed by the Quantity Theorists to demonstrate this relationship. But it is not the purpose here to discuss the theoretical and statistical aspects of this important proposal. Rather, our purpose is to review economic and financial developments over the last few years and to ask whether a rule calling for a constant rate of money growth would have been feasible.

Adoption of a rule calling for a constant rate of growth in the money supply implies that the monetary authority does not concern itself about credit market conditions. Shifts in demand or supply conditions in these markets will be reflected in changes in interest rates, and flows of funds into and out of particular sectors of the markets will be directed by changes in relative interest rates. Also implied in the rationale for such a rule is the idea that if the monetary authority adopts an appropriate policy, the fiscal policy that is followed makes little difference. A Government deficit financed by borrowing from the public, for example, will result in a shift in purchasing power from the private to the public sector, accompanied by changes in interest rates, and total spending will be unaffected by the deficit.

This whole position has been questioned by many leading economists on basic theoretical grounds. But the policymaker must subject every proposal to one final question: Will it work? A close scrutiny of economic and financial developments over the past three years raises a serious question as to whether the Federal Reserve System could have held the growth in the money supply to a fixed rate of increase without at times endangering the viability of financial markets and of important sectors of the real economy. This period saw wide swings in demands on the capital market, particularly on the part of the Federal Government. Because of market imperfections and institutional rigidities, these swings subjected particular sectors of the financial market and important areas of the economy to intense pressures.

A case in point is the year 1966. It will be recalled that inflationary pressures had begun to appear in 1965, partly because of a rapid expansion in Government spending, but also because of a strong rise in business investment. In the absence of any significant fiscal action to contain the inflation, the Federal Reserve attempted to hold the line with monetary policy. Bank reserves increased at an annual rate of 1.7% from the end of January through June of 1966 and actually showed a decline of 2.1% from June through November. The narrowly defined money supply, after growing fairly rapidly through the first four months, remained virtually unchanged through the remainder of the year. Bank credit continued to expand at a fairly strong pace through June, but there was almost no increase from June through November.

The effects of these developments on financial markets and the economy are well-known. Interest rates, which had begun to rise in 1965, shot upward very rapidly in 1966, especially in the third quarter. The demand for borrowed funds remained strong, and in some instances the scramble for liquidity reached almost panic proportions.

The impact on various sectors of the credit markets and the economy was by no means uniform. In the second and third quarters, flows of savings into thrift institutions fell to less than half the rate of 1965, and the increase in time and savings deposits at commercial banks was sharply reduced in the second half. The flow of funds into the mortgage market was greatly curtailed and this was reflected in a sharp decline in residential construction. State and local borrowing in financial markets in 1966 was about one-fifth below the 1965 level; the level in the third quarter of 1966 was almost a third below the first half rate, after allowance for seasonal forces.

Some of these developments are shown on the accompanying charts, but these charts do not reveal the degree of tension in financial markets, or of the pressures on financial institutions. In the words of the Annual Report of the Board of Governors of the Federal Reserve System, ". . . the period [June 8-September 13, 1966] was marked by progressively deepening gloom in all financial markets. Indeed, by late August—before official policy actions succeeded in restoring a degree of calm in early September—there were even some fears being expressed that a financial crisis might be near at hand." One of the policy actions referred to was the issuance of a letter by the Federal Reserve System assuring member banks that funds would be available at the discount window to meet unusual liquidity pressures and requesting the banks to make necessary portfolio adjustments by holding down the growth in business loans rather than by further liquidation of tax-exempt and other securities.

The 1966 experience would seem to support those who advocate a steady growth in the money supply. Perhaps it does. To be sure, if money had increased at an annual rate of (say) 3% throughout 1966, pressures on financial markets and interest rates would have been less severe. There is a strong probability, however, that given the strong demand pressures in the economy, such a policy would have failed to halt the growth of inflation.

But the larger lesson to be learned from the 1966 experience is that monetary and fiscal policies must be coordinated if a rational approach to stabilization policy is to be achieved. Economic conditions in 1966 called for a budget surplus and a reduction in demands of the Federal Government on the money and capital markets. Instead, there was a budget deficit and the Government raised over $6 billion in financial markets, twice as much as in 1965. In the face of the burgeoning demands, the attempt to do the stabilization job with monetary policy alone revealed institutional rigidities which placed severe strain on a few sectors of the economy. The existence of such rigidities raises serious question as to the feasibility of the "money only" approach.

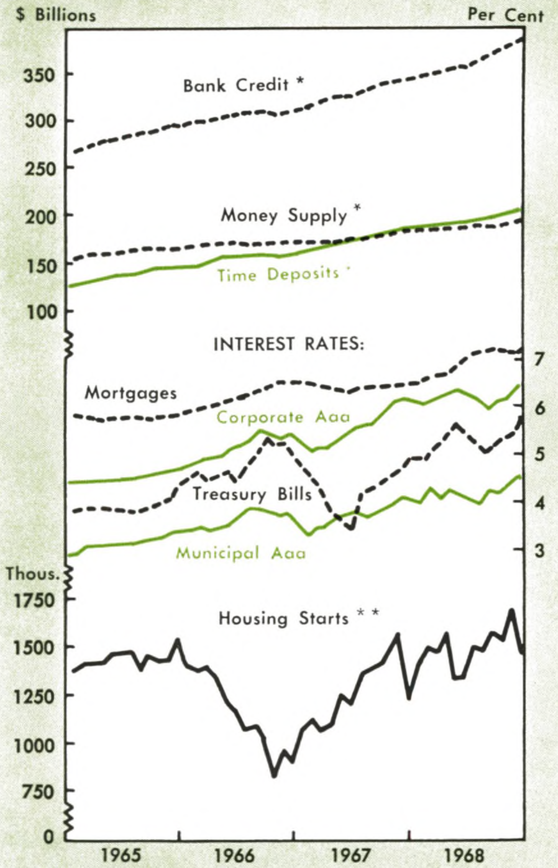
The 1966 experience indicates that, given the institutional setting in which the Federal Reserve operates, there is a limit to the height to which interest rates can be pushed in a short period of time without causing serious distortions in flows of funds through the economy. These distortions arise partly because of legal restrictions on certain interest rates. Rates that savings institutions and commercial banks may pay on deposits are controlled. Most states have usury laws and some impose legal limits on rates that may be paid on state and local obligations. On the other hand, an institution's asset structure may place a practical ceiling on the rate it can pay on savings deposits. This is the case when most of an institution's assets are in the form of long-term mortgage loans and most of its liabilities in the form of savings deposits. To avoid losing funds when interest rates are rising, such an institution must increase the rate it pays on deposits, thus raising the cost of almost all of the funds it uses. But since the yield on its assets remains virtually fixed, there is a limit as to how high it can go in competing for funds, even in the absence of legal restrictions.

Some of these institutional obstacles have been eased somewhat since 1966. Many states have raised usury rates and some are in the process of raising limits on rates that can be paid on state and local obligations. At the same time, an effort has been made to introduce a little more flexibility and liquidity into mortgage markets. But if all the man-made restrictions were removed, which will not be done, there would still remain many inherent imperfections in the markets for financial assets and for real goods. In short, the high degree of perfection in market performance called for in the quantity theory model is not likely to be attained.

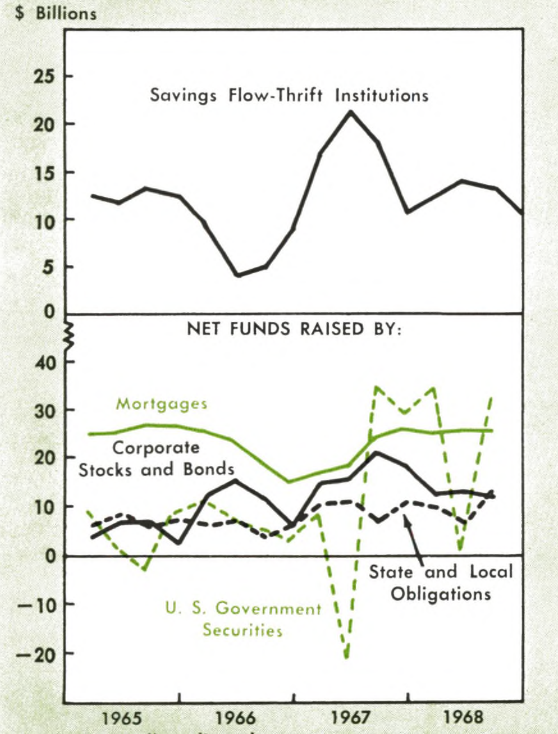
The foregoing is not intended as an apologia for the monetary policy that was followed in recent years. The men who make monetary policy are human and are subject to the same errors of judgment as are other men. It may be said in their defense, however, that their decisions are usually made under pressure and on the basis of imperfect information. They do not have the benefit of hindsight or the second guess. Moreover, they are concerned with the problems of the real world with all its imperfections, not one constructed as they would like to have it. Nevertheless, there is little to suggest that had they followed a rule calling for a fixed rate of growth in money instead of the discretionary policy they did follow, that monetary policy would have been more effective than it was in the period since 1965.

Indeed, there is much to suggest that, given the fiscal policy that was followed, such a rule probably would have resulted in a disruption of financial markets with serious implications for the real sector.

ECONOMIC AND FINANCIAL INDICATORS



FLOWS OF FUNDS**



*Seasonally adjusted.
**Seasonally adjusted annual rates.
Source: Board of Governors of the Federal Reserve System, Bureau of the Census, and Federal Home Loan Bank Board.

The accompanying chart, based on flow of funds data (seasonally adjusted) indicates the swings in Federal Government demands for funds over the past three years. These swings have been particularly large since 1967, ranging from a repayment of over $5 billion in the second quarter 1967 to borrowings of almost $8.7 billion the next quarter. Looked at another way, the Federal Government found it necessary to raise funds totaling less than $3 billion in the fiscal year ending June 30, 1967. In the following fiscal year it borrowed $23 billion. Oftentimes these fluctuations are accompanied by comparable swings in private demands on financial markets. Faced with this sort of situation, is the monetary policymaker to hold the growth in the money supply to a fixed rate (and risk possible serious damage to both the financial system and the economy) or should he cushion the impact by permitting money to grow at a faster or slower pace than might be called for by a fixed rule? If he does the latter, how much flexibility is possible without returning to a discretionary policy?

Much credit belongs to those who have helped to restore monetary policy to its proper place in the arsenal of stabilization weapons, especially to those who stressed the role of money when that was a lonely position to take. Those who now make exaggerated claims for monetary policy are not furthering the cause of monetary policy or of economic stability. One important reason why monetary policy has been criticized so severely in recent months is that we have asked too much of it. For several years monetary policy was called upon to achieve economic stability without the support of an appropriate fiscal policy. This is more than we can reasonably expect of it.

Aubrey N. Snellings

—ERRATUM—

In the April *Monthly Review* article, "The Federal Debt," the maturity of Series H savings bonds should have been stated as ten years instead of seven years.

Stock Exchange Membership

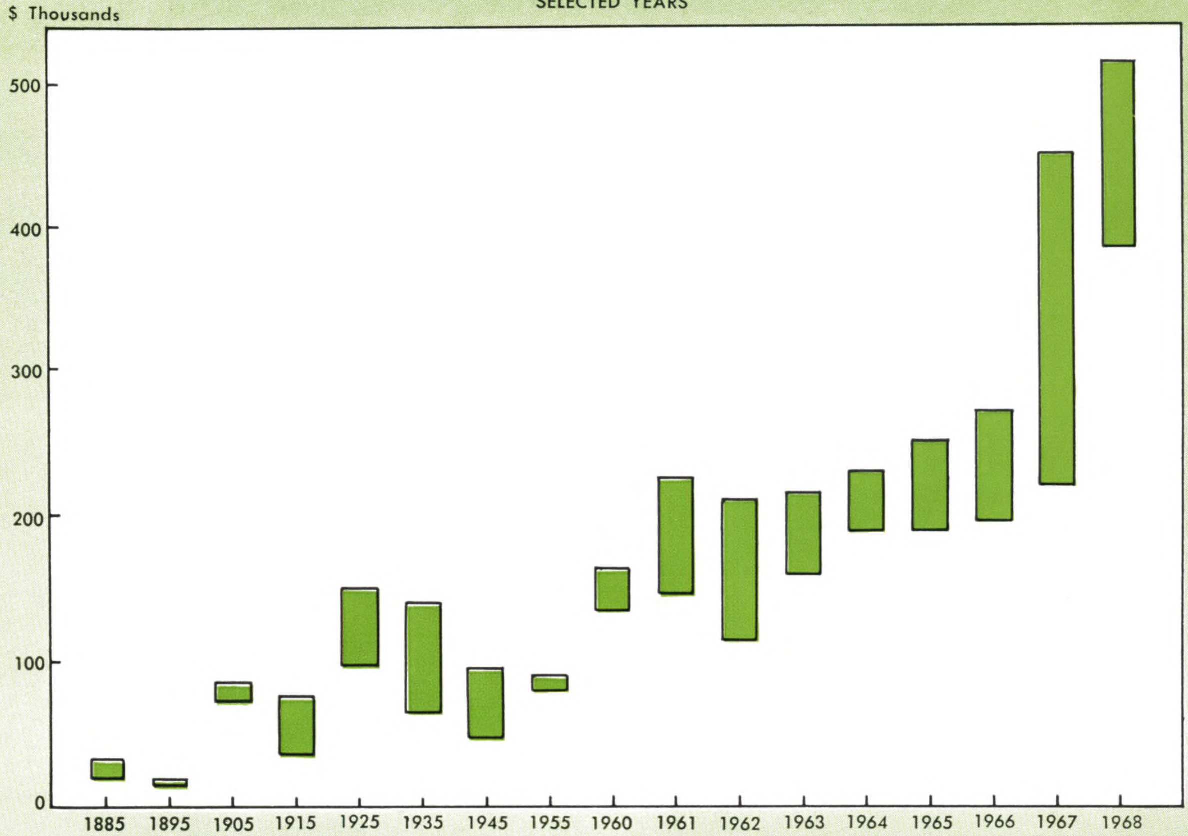
A break with political tradition laid the foundation for the first stock exchange in the United States. Instead of having the customary party at the close of his term of office, the mayor of Philadelphia in 1746 created a fund for the founding of a marketplace for business, which was opened in a coffeehouse in 1754. The formation of an association of brokers in Philadelphia in 1790 was the beginning of the modern stock exchange.

The New York Stock Exchange followed closely in 1792. There a group of brokers met each day under a tree on Wall Street to trade in the stocks of a few insurance companies and banks and in the bonds of the new United States Government. When the brokers moved inside to a rented room on Wall Street, each member was assigned a specific seat. Thus, the phrase "seat on the exchange" became synonymous with membership, although today the term has figurative meaning only.

Since these first two exchanges, over 100 other exchanges have existed in this country. Today there are 16 stock exchanges. Some of these have been formed by the consolidation of several exchanges. For example, the Pacific Coast Stock Exchange was formed in 1957 by the unification of the San Francisco and Los Angeles Stock Exchanges.

In 1868 the New York Stock Exchange erected its first building, financed by contributions of members. To protect each member's equity in the building, a limitation was placed on the number of mem-

RANGE OF NEW YORK STOCK EXCHANGE MEMBERSHIP PRICES
SELECTED YEARS



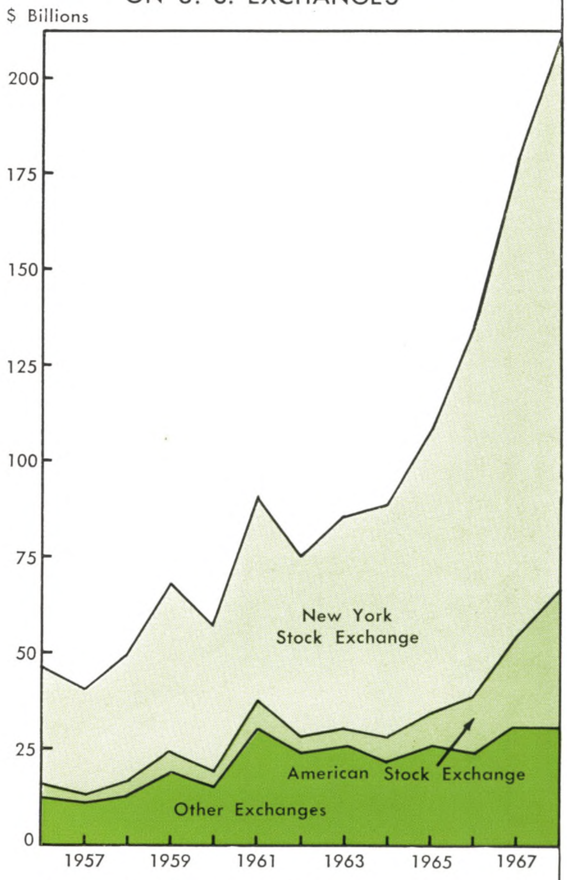
Source: New York Stock Exchange.

bers and seats were made transferable; before 1868, when a member died his seat was sold and the proceeds went to charity. In 1868 the number of members on the New York Stock Exchange was limited to 533. In the late nineteenth century 230 members were permitted on the Philadelphia Stock Exchange. The number of seats on various exchanges has changed over the years due to consolidations of exchanges and to the need for more members to accommodate the growing amount of business. Today the number of members permitted on exchanges ranges from 1,366 on the New York Stock Exchange, to 70 on the Detroit Stock Exchange, and to 7 on the Richmond Stock Exchange.

The value of membership on an exchange derives from the right of the owner to transact business on the exchange floor. The owner also has the power to influence the rules that govern the exchange. Over the years the value of seats on various exchanges has reflected in part the amount of commissions or the volume of potential business, and thus prices have varied widely. When membership was first made saleable on the New York Stock Exchange, a seat sold for around $7,000. The price went as low as $2,750 in 1871. In 1929 a seat plus a one-quarter right to another seat sold for $625,000. During World War II when trading volume dropped, the price fell as low as $17,000. As can be seen from the chart, the total value of stock transactions on the New York Stock Exchange exceeds the value of transactions on any of the other exchanges. Reflecting these differences, a record $515,000 for a single seat on the New York Stock Exchange was paid in 1968 compared to a 1968 high of $335,000 on the American Stock Exchange and $28,000 on the Boston Stock Exchange.

All stock exchanges impose controls over the character and business reputation of prospective members by requiring exchange approval. Most exchanges require a member to be at least 21 years old and a citizen of the United States. Some, for example the Detroit and Midwest Stock Exchanges, allow Canadian members. In 1968 a European securities firm was given trading privileges on the Boston Stock Exchange.

VALUE OF STOCK TRANSACTIONS ON U. S. EXCHANGES



Source: Securities and Exchange Commission.

Seatholders perform several functions. Commission brokers, who make up the largest group, are partners or officers of firms which transact business with the public. They execute orders on the exchange for their customers. Many firms have more than one member on a single exchange and many have members on several exchanges. A specialist helps maintain a fair and orderly market in the few stocks in which he specializes. Odd-lot dealers serve investors who trade a few shares of stock at a time rather than in round-lots or 100-share units. Floor brokers are members who are not associated with a member firm but assist commission brokers who may be too busy to handle their orders quickly. Traders deal for their own account but their transactions must meet certain requirements set forth by an exchange.

Mary Ann Chappell

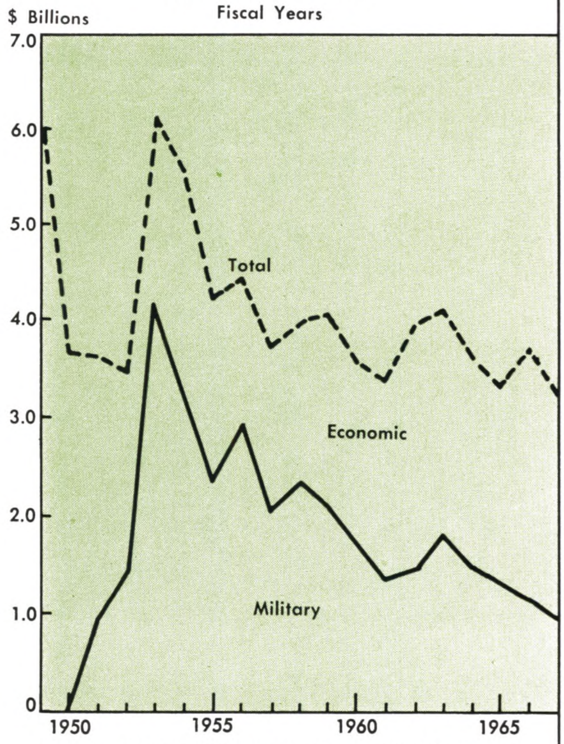
United States Foreign Assistance

Since World War II U. S. foreign assistance has ranged from rebuilding war-torn areas and aiding victims of natural disasters to resisting aggression in various parts of the world and financing economic development. This article discusses the history of U. S. foreign aid efforts and the current attempt to help the so-called "less developed" nations.

Background The U. S. made a small loan to China in the late 1930's and gave some limited assistance to South American countries in the early 1940's, but did not become deeply involved in foreign aid until World War II. In 1941 under the Lend-Lease Act the President was granted the authority to aid the Allies, and in 1943 Government and Relief in Occupied Areas was initiated to establish some order in war areas after the troops withdrew.

In 1945, the United States became more active in the foreign aid effort. Congress approved U. S. membership in the World Bank and the International Monetary Fund. These had been established in 1944 by the Bretton Woods Agreement and provided for closer economic cooperation among the members.

U. S. GOVERNMENT FOREIGN ASSISTANCE
MILITARY—ECONOMIC
Fiscal Years



Source: Statistical Abstract of the United States.
Note: 1949 data includes 3 months of 1948.

In the same year Congress expanded the operations of the Export-Import Bank (established in 1934 to finance the sale of U. S. exports) and extended Lend-Lease aid for another year. In 1946, a loan of $3.75 billion was authorized for Great Britain and aid was extended to both Greece and Turkey. In addition, the Interim Aid Act of 1947 offered some assistance to the European countries until the European Recovery Program could get underway.

Immediate Postwar Period In 1948 a long-run commitment to aid the war-torn European countries was made by the U. S. in the form of the European Recovery Program, or "Marshall Plan." A Committee of European Economic Cooperation was formed by 16 Western European countries, which presented a united plan for recovery, specifying what U. S. aid was needed and committing themselves to a program of economic cooperation and reform. In the U. S. the Marshall Plan led to the birth of the first independent aid agency, the Economic Cooperation Administration.

The Soviet blockade of Berlin in 1948 was a major reason for a shift in emphasis in the U. S. aid policy from economic to more military. This shift began with the signing of the North Atlantic Treaty in 1949 and continued through the Korean War. The first chart indicates the fluctuations between the economic and military portions of U. S. foreign aid since 1949. (Data for this chart are not identical with those in the balance of payments, mainly because of differences in reporting, timing, and treatment of particular items.)

Assistance in the 1950's In the early 1950's the emphasis of foreign assistance remained on military help, but an increasing amount of military aid began going to Asia. This shift in aid was primarily a result of the Korean War. In 1951 all types of U. S. assistance, except that given by the Export-Import Bank, were combined in the Mutual Security Act. The shift in assistance from Western Europe to Asia and more recently to the less developed areas of Africa and South America is shown in the second chart. India, one of the major recipients, is listed in the Near East and South Asia category and Viet Nam is in the Far East and Pacific region.

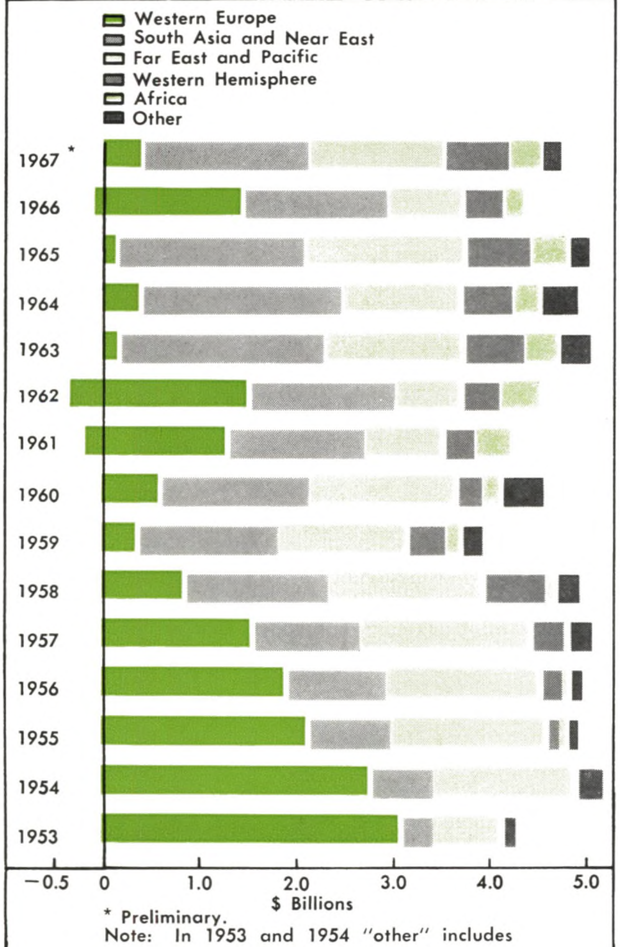
One of the new programs added to the foreign aid program during the 1950's was the Agricultural Trade Development and Assistance Act of 1954. Under this Act the Department of Agriculture sells surplus farm commodities abroad and the proceeds are usually used in the same country for loans or grants for economic development.

Several shifts in U. S. foreign assistance policy became apparent in the late 1950's. Military aid declined sharply after the 1953 cease-fire in Korea and the share of total aid in the form of economic assistance increased steadily. At the same time there was a shift in the form of assistance from grants to loans, as shown in the third chart.

The Development Loan Fund, established in 1957, was designed to make loans on easier terms than those provided by existing institutions. Most of these loans in the beginning were "soft" loans, that is, repayable in the recipient's currency which was often nonconvertible. Later, as the U. S. developed balance of payments problems, more of the loans became "hard," or repayable only in dollars.

The U. S. balance of payments deficit has been a problem since 1958. In order to alleviate the impact of the assistance program on the balance of payments problem the U. S. began in 1959 to "tie" some of its aid to the purchase of U. S. products. In addition, the U. S. began at this time to urge the other developed countries to offer more support to the less developed areas. In 1961 the Organisation for European Economic Cooperation countries joined with the U. S. and Canada to form the Organisation for Economic Cooperation and Development (OECD). The Development Assistance Committee (DAC) of the OECD was formed to increase and coordinate official aid to the less-developed areas.

NET MAJOR U. S. GOVERNMENT FOREIGN ASSISTANCE BY AREA



* Preliminary.
Note: In 1953 and 1954 "other" includes Western Hemisphere and Africa.
Source: Statistical Abstract of the United States.

The fourth chart compares the foreign aid efforts of the U. S. and several of the other developed countries. Total foreign aid payments for each country are expressed as a per cent of its Gross National Product. Expressed in these terms, France's foreign aid contribution has been a good deal larger than that of the U. S., Japan's somewhat smaller, and that of Germany and the United Kingdom about the same. In actual dollar amounts, however, the U. S. contributes over half of the total given by DAC countries. Some of the Western European countries have concentrated their assistance efforts on their present or former colonies, primarily in Africa.

In January 1960 the Inter-American Development Bank (IADB) was established by the U. S. and the Latin American countries, and since then area development banks have been established for both Asia and Africa. These institutions are concerned primarily with long-term development loans.

The Current Foreign Assistance Effort The U. S. foreign aid program was again reorganized in 1961. All economic aid became the responsibility of the Agency for International Development (AID), and all military aid responsibility was given to the Defense Department. One new program added to the U. S. assistance program at this time was the Alliance for Progress which provided for increased economic aid and cooperation between the U. S. and 19 Latin American countries.

AID usually administers assistance in one of three ways. The largest part of the assistance is in the form of "developed loans," which may be used to finance development projects or to finance import programs which enable the government or private businessmen in the recipient country to purchase essential supplies and equipment. These loans are repayable only in dollars with the minimum interest rate and other terms set by Congress.

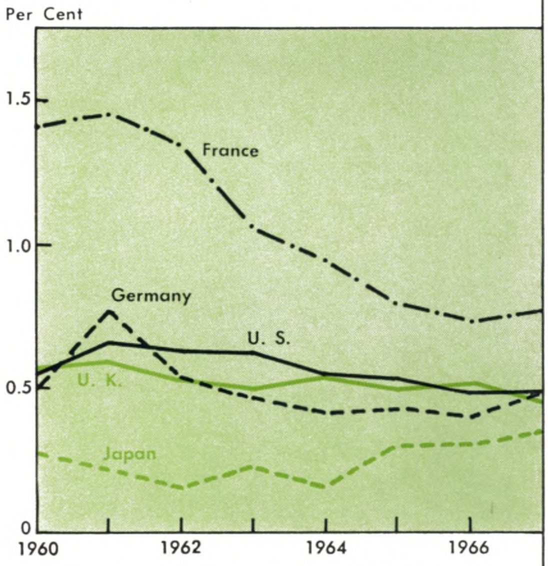
The second form which assistance may take is the "technical cooperation/development grant." These grants pay the salaries of technicians serving overseas, supply them with needed materials, and finance technical assistance contracts.

Thirdly, "supporting assistance" finances the sale of American products in countries where large defense expenditures are straining the recipient country's economy. Funds coming from "supporting assistance" are usually loaned but can involve direct dollar transfers. In addition, AID has a contingency fund to cover unforeseen emergencies.

The Peace Corps, formed in 1961, is the newest approach to U. S. foreign assistance. From an original appropriation of $4 million, the Peace Corps has grown until its 1967 appropriation reached $108 million. Administered through a separate agency from AID, the Peace Corps sends volunteers to work for two years in foreign countries whose governments have requested them.

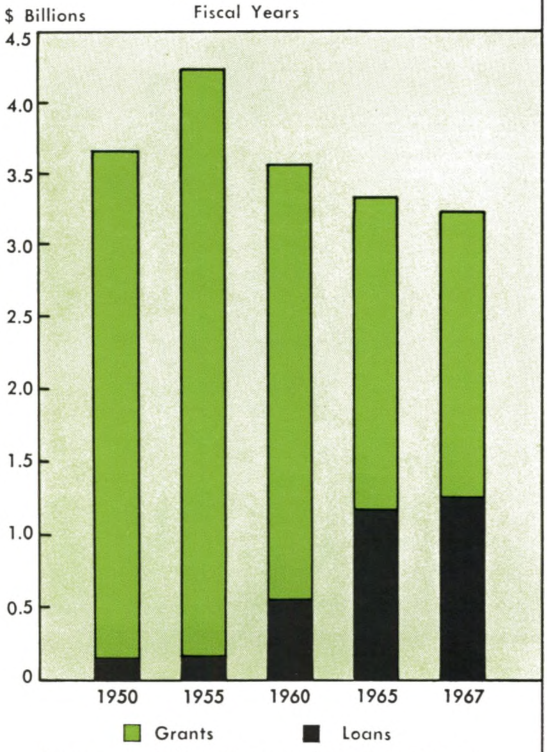
Conclusion Large scale U. S. foreign assistance began as an effort to help rebuild Europe after World War II. The program has evolved through a period of military aid during the early 1950's to one currently concentrating on economic aid in the form of loans to less developed countries. Shifts from grants to loans and the tying of aid have lessened the effect of aid on the U. S. balance of payments deficit.

FOREIGN AID PAYMENTS BY SELECTED COUNTRIES AS A PER CENT OF THEIR GROSS NATIONAL PRODUCTS



Source: Organisation for Economic Co-operation and Development.

U. S. GOVERNMENT FOREIGN ASSISTANCE
GRANTS—LOANS
Fiscal Years



Source: Statistical Abstract of the United States.

The pros and cons of the U. S. assistance efforts have been extensively debated but basic questions are still unanswered. Should aid be concentrated in a few areas that appear to have the best chance of rapid development in the near future, or should efforts go to the poorest nations? Should the U. S. aid program be based primarily on humanitarian concern for those less fortunate or should it be designed mainly for defensive purposes? How much should domestic problems and the balance of payments problem influence the aid program? Should aid be bilateral (just between the U. S. and the recipient) or should it be multilateral (from the combined funds of several countries), or should it be channelled through an international body such as the UN? Should aid be primarily an official Government act or should the private sector take over a larger share?

Perhaps the largest question of all concerns the U. S. foreign assistance effort of the future. A foreign assistance effort of some type appears to be a permanent commitment, but the above questions will have to be answered in determining what form the assistance will take.

Katherine M. Chambers

The Fifth District

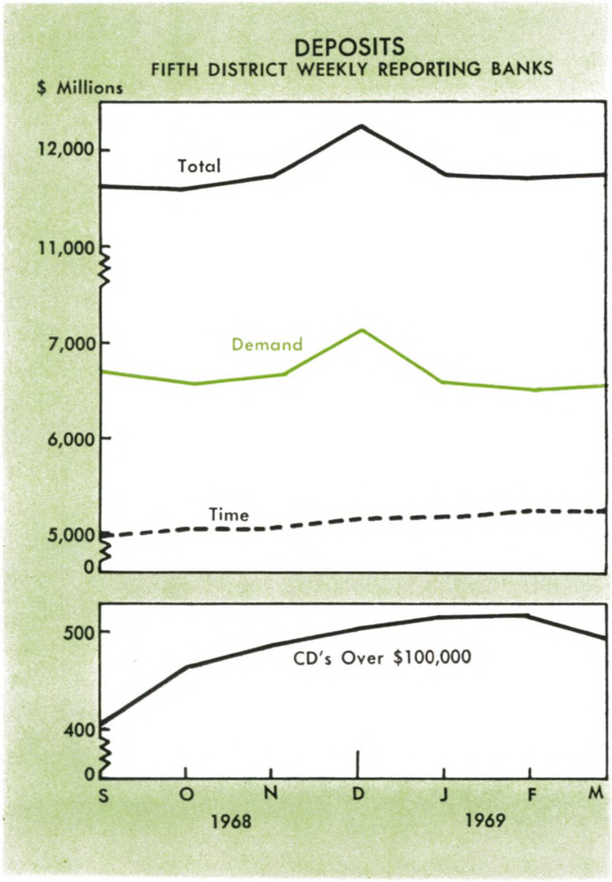
BANKING

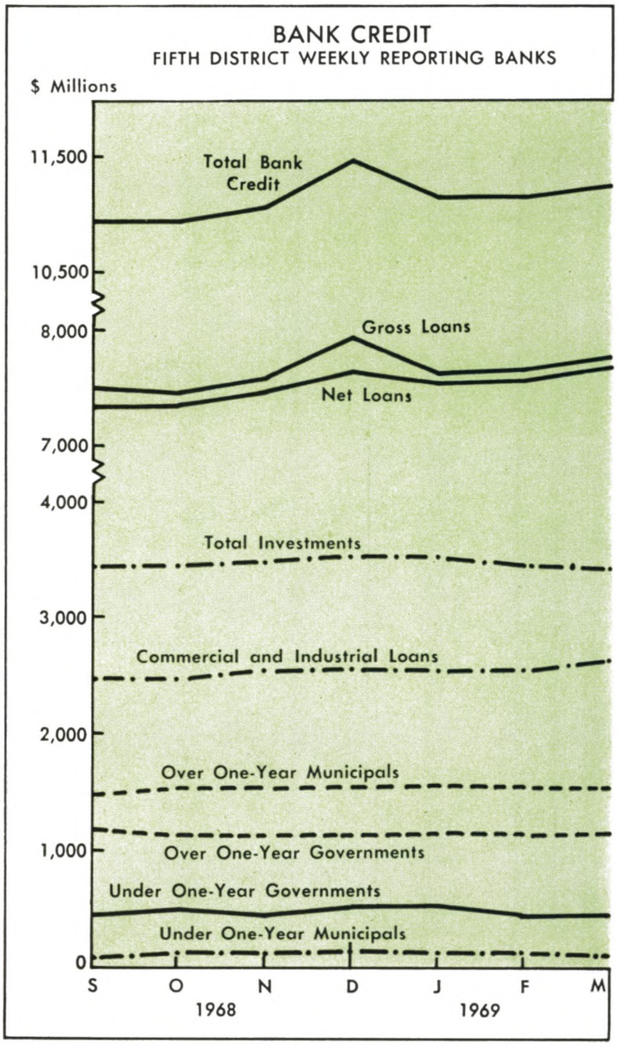
The first quarter of 1969 was characterized by a gradual tightening in the positions of Fifth District banks. This tightening was particularly evident in reduced demand deposits and an unseasonably slow rate of growth in time deposits. The results of these weaknesses in sources of bank funds combined with a strong demand for loans was reflected in substantially reduced investments, particularly short-term Governments, and heavy borrowing from the Federal Reserve.

Total deposits at Fifth District weekly reporting banks dropped $525 million, or about 4.5%, during the first quarter of 1969. The decline in total deposits was accounted for by a $619 million, or 9.5%, reduction in demand deposits and a $95 million increase in time deposits. A reduction in demand deposits is typical for the first quarter of the year. This decline, however, appears to be larger than seasonal.

The increase in time deposits appears to be smaller than is customary for the first quarter. This weakness reflected in part some runoff in certificates of deposit (CD's). Both the decline in CD's and the weakness in other time deposits reflected their poor competitive position relative to other market opportunities.

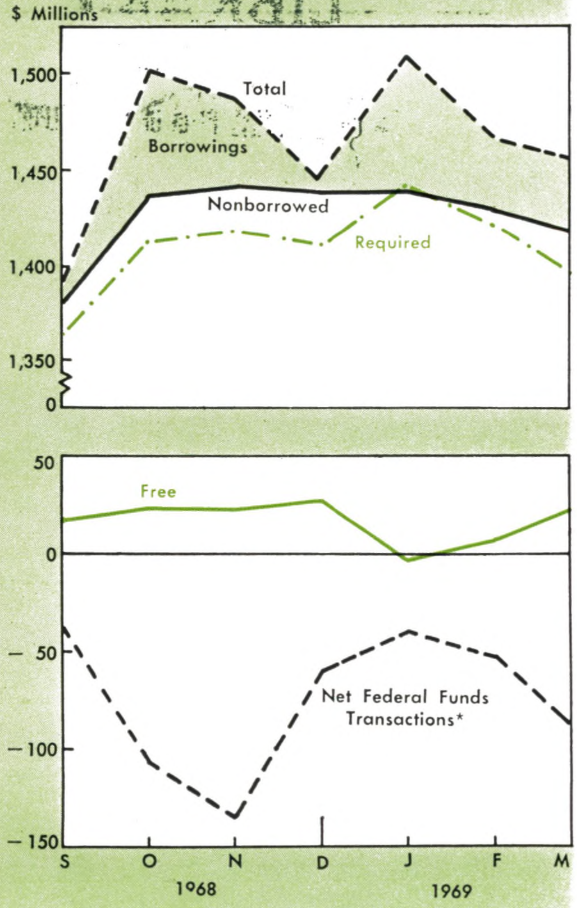
Total bank credit at the 28 weekly reporting banks fell $221 million, or 2.0%, in the first quarter of 1969, a typical seasonal decline. Gross loans fell





by $118 million, or 1.5%, while net loans (gross loans less loans to domestic commercial banks) actually increased in the first quarter, by $65 million. This increase in net loans was primarily accounted for by a $48 million increase in commercial and industrial loans. Real estate loans also rose by $32 million. All other types of loans showed no significant increase or actual declines.

MEMBER BANK RESERVES, BORROWINGS AND FEDERAL FUNDS TRANSACTIONS



*Sample of 18 weekly reporting banks.

The increase in net loans was contrary to the typical seasonal pattern. This unusual strength in net loans, in the face of declining bank credit, reflected a strong loan demand and the desire of bankers to accommodate this demand wherever possible, usually at the expense of investments.

Investments, which account for about one-third of Fifth District bank earning assets, fell by $103 million, or 3.0%, in the first quarter of 1969. Most of the decline came in short-term Governments, which fell by 9.2%, while short-term municipals declined by 4.6%. These reductions in short-term holdings reflected the banks' liquidation of investments in order to accommodate the strong loan demand.

As a result of declining deposit balances and heavy loan demand, some pressure was placed on the reserve positions of Fifth District member banks. The average level of borrowing from the Federal Reserve in the first quarter increased 18.6% from the average level in the fourth quarter of 1968. The level of Federal funds transactions, as reported by a sample of 18 member banks, remained high, and these banks generally were net purchasers of Federal funds. The average interest rates on Federal funds gained a whole percentage point from December 1968, again reflecting the tight situation in money markets.

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