



TWELFTH FEDERAL RESERVE DISTRICT

# MONTHLY REVIEW

OCTOBER 1950

FEDERAL RESERVE BANK OF SAN FRANCISCO

## THE DOLLAR AND THE DOLLAR GAP

**D**URING the month of August the merchandise export surplus of the United States was replaced by an import surplus and thus at least for one month the "dollar gap" was eliminated. This news does not come as a surprise to those who have been following the trend of our balance of trade in the recent past. It culminates a sharp upward trend in our merchandise imports and a decrease in merchandise exports which developed immediately after the outbreak of hostilities in Korea. However, if one goes back to a year ago, to August 1949, the significance of this reversal in our trade position and the rapidity with which it has taken place becomes clear. It will be remembered that August 1949 was the month preceding the devaluation of the pound sterling and the round of devaluations which followed; it was the month of a serious sterling crisis. If at that time anyone had predicted that within a year's time the dollar gap would be closed, he would have been accused of the most fanciful thinking.

The balancing of our exports and imports has been accompanied by other closely related events: the building up of dollar and gold reserves in many of the former deficit countries and the resulting loss of gold by the United States; the appreciation of the Canadian dollar as a result of establishing a free market for this currency; and finally the persisting rumors of appreciations or re-

valuations of the pound sterling, the Australian pound, and the Mexican peso.

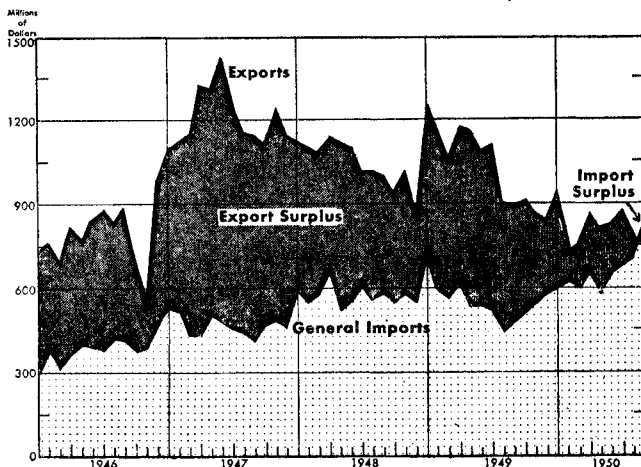
In order to interpret the significance of these developments a number of points of primary significance should be considered. We want to know first, what has actually happened to our balance of trade; second, the more important explanations of our shrinking export surplus; third, the future of our program of foreign aid under ECA in view of rapidly increasing dollar and gold balances in the hands of recipient countries; and finally, the possible effects, good or bad, upon our economy and the world economy of our changing trade position.

### Postwar balance of trade

Our export surplus reached its peak in 1947, amounting to \$8.7 billion for the year. For the year 1948 our excess of merchandise exports was considerably reduced, to \$5.3 billion. This rate of decrease was not continued into 1949, however, and the export surplus amounted to \$5.2 billion for that year. During 1949, the trend of exports was downward throughout the year; at the same time imports were decreasing at a faster rate in response to the brief recession in the early part of the year in the United States. In August 1949, however, the value of imports turned upward, establishing a trend which has continued to date, and which increased sharply following the outbreak of hostilities in Korea. Exports, on the other hand, continued declining through January 1950 at which time they turned upward until they were sharply curtailed in July.

For the month of August of this year, according to preliminary figures of the Department of Commerce, the value of our total imports set an all-time high of \$819.4 million—50 percent above the 1949 monthly average and

UNITED STATES IMPORTS AND EXPORTS, 1946-50



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29 percent above the average for the first six months of 1950. Total exports, on the other hand, were valued at \$760.7 million—25 percent below the monthly average for 1949 and 7 percent below the average for the first six months of 1950. This August import surplus of \$58.7 million is the first import surplus that has been recorded for any month since June 1937.

The most important commodities accounting for the increase in imports were coffee, sugar, rubber, copper, lead, tin, and petroleum. Among our exports, the largest decrease took place in the machinery and vehicles classification.

Turning next to specific trading areas, we find that from January through July of 1950, an import balance was recorded with Latin America, the Far East, and Africa, while our trade with Europe continued to show an export balance. It is interesting to note that our total surplus of merchandise exports for this period amounted to \$1,147,356,000, which is practically identical with the export surplus with the ERP countries of \$1,147,259,000. By comparing our merchandise balance for the first seven months with the same period in 1949, the rapidity with which the dollar gap has been closing becomes apparent. In the first seven months of 1949 our total export surplus amounted to \$3.7 billion, over three times as large as the total of \$1.1 billion for 1950. Similarly, in the case of the ERP countries our export surplus has been approximately halved from \$2.3 billion in 1949 to \$1.1 billion in 1950. Turning to other areas we find that with Latin America our export surplus for 1949 of \$344 million has become an import surplus of \$89 million; in the Far East an export balance of \$548 million was changed to an import balance of \$3 million; similarly, in the case of Africa an export balance of \$204 million became an import balance of \$50 million; our export surplus with Canada for 1949 of \$324 million was reduced to \$49 million in 1950; and finally, when we look at the British Commonwealth of Nations as a special category, we find the largest change—from an export balance of \$858 million to an export balance of only \$41 million. During the month of July 1950, our merchandise trade with the Commonwealth crossed over the line to the import surplus side, with a total excess of imports of \$39 million.

#### ***The role of ECA in our declining export surplus***

In considering the underlying reasons for this rapid narrowing of the dollar gap and its actual closing in August, it appears that there are four primary factors which should be noted: our program of economic assistance under ECA, the effect of the devaluation of foreign currencies vis-à-vis the dollar, rapidly increasing prices of certain basic United States imports, and finally, the effects of the Korean incident and the resulting stimulus to rearmament.

In considering the explanations of the present trend in our merchandise trade, it will be seen that many of the factors may be of a temporary nature, or if not temporary

at least uncertain as to their effective duration. Our ECA program of economic assistance can be considered as long run in its consequences. The basic economic objective behind our ECA program, and particularly its European Recovery Plan segment, has been to increase productivity in the countries of Western Europe and by so doing reduce their dependence upon United States imports and increase their ability to export. Stated baldly, our ECA program has sought to reduce the dollar gap. In accomplishing the objective of increasing productivity in Western Europe, ECA has been highly successful, and it must be given a large share of the credit for Western Europe's improved trade position. Productivity in Western Europe was returned to prewar levels by 1949 and has since been expanded above this point. Europe thus has been able to produce for itself many of the commodities previously imported from the United States and at the same time has been able to produce a surplus for export both to the United States and to the rest of the world. The ECA program was not intended to eliminate the United States export surplus with Western Europe; rather, it represents an attempt to reduce the surplus to manageable proportions. The objective is to reduce Western Europe's import surplus with the United States to a point where it can be covered by the export of goods to dollar surplus countries of the world and thus bring about an over-all balance through multilateral trade. The expenditure of almost \$10 billion<sup>1</sup> for economic rehabilitation by ECA, therefore, has been a major factor in the declining dollar gap.

#### ***The effect of the devaluations of September 1949***

The second factor playing a major role in our decreasing export surplus, and by contrast a much more temporary and less tangible one, has been the devaluation of many foreign currencies initiated by the devaluation of the pound sterling in September 1949. As has been pointed out earlier, the situation in the United Kingdom a year ago on the eve of devaluation was indeed critical. United States imports from the United Kingdom had fallen off sharply as a consequence of the recession in the United States in the early part of the year. This resulted in a drain on British dollar and gold reserves in spite of large-scale United States assistance. In addition, there was the complicating factor of large accumulated sterling balances to the account of other countries. Sterling creditor countries were insisting upon release of these balances to pay for current British exports. Britain, on the other hand, realized that a part of these balances had to be released in order for her to maintain and expand her markets in these countries. The result was a considerable volume of "unrequited exports," and thus at a time when she could ill afford it, she was exporting a part of her output for which she realized no current return.

The decision by the United Kingdom to depreciate the pound by 30 percent vis-à-vis the dollar was promptly followed by similar action on the part of all the sterling

<sup>1</sup> Cumulative ECA foreign aid totaled \$9,828,930,000 on October 17, 1950.

countries except Pakistan and also by a 9 percent depreciation of the Canadian dollar. The great importance of this group of countries in world trade soon forced most of the other countries of Western Europe and many other overseas areas to devalue their currencies. Thus, in effect, what actually occurred was an appreciation of the dollar in relation to other currencies. This relative appreciation of the dollar constituted a recognition of the deterioration of many non-dollar currencies against the dollar and a recognition that the parities that had been set up at the end of the war were unrealistic.

The success of any devaluation is to a certain extent a gamble and the September devaluations were not an exception. The gamble in this case, however, has paid off, although aided, it is true, by other developments. A devaluation, in effect, lowers the price of a country's exports expressed in foreign currencies and, at the same time, increases the price of imports in terms of the domestic currency. A devaluation may be said to turn the terms of trade against the devaluing country, in the sense that a given volume of exports can be exchanged for a smaller volume of imports than could have been obtained before the devaluation of its currency. It is hoped, however, that the disadvantageous change in the terms of trade will be more than offset by an increased demand for its exports as a result of the lower price. If this is the outcome, the devaluing country will receive an absolute increase in the amount of foreign exchange obtained. Such an advantage, however, assuming the demand response to the lower price is sufficient to produce the desired results, may be a furtive one if imported raw materials are important in the country's productive process. The increased cost of imports which accompanies a devaluation must eventually be reflected in increased costs of production and thus in export prices. In this way, if prices of imports increase sufficiently and imports are of significant importance in the particular economy, the effects of a devaluation and the advantages obtained may be short-lived. In the case of the United Kingdom this danger has been avoided, at least up to the present. On the average, the prices of British imports have increased 21 percent since devaluation, but the prices of British exports have increased only 7 percent.

In the case of the September 1949 devaluations, however, certain additional factors should be considered. Because the devaluations were so widespread, the resulting price reductions were, with few exceptions, effective only in terms of the dollar. Thus not only was it hoped that exports to the United States would increase, but in addition that exports could be diverted from non-dollar areas to dollar areas. According to studies of the International Monetary Fund covering the flow of world trade through February 1950 (and thus unaffected by the Korean developments), such a shift did take place. This is an important factor when it is remembered that production was at a high level in the devaluing countries, and could not be increased readily in response to United States demand. Second, since many of the raw material producing coun-

tries were within the devaluing group, the price of raw materials would not immediately rise in other devaluing countries, and, in fact, would not rise except to the extent that competitive bidding against dollar purchasers became necessary, a contingency which has become a reality in recent months.

While the devaluations might also be expected to decrease imports from the United States owing to the increase in prices expressed in the domestic currencies of the devaluing countries, this effect was insured, at least by the sterling area countries, by an additional provision to reduce imports from the United States arbitrarily by 25 percent of the then existing level.

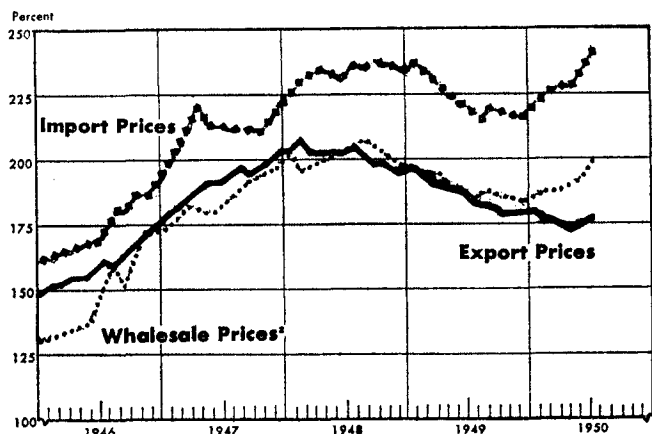
Now, almost a year after the devaluations, it would appear that these expectations have been realized. Certainly the desired results as evidenced by the reduction in dollar deficits and the growth of dollar and gold reserves, as typified by the doubling of Britain's reserves since the devaluation, would indicate that the devaluation had been successful even beyond the most optimistic expectations. Unfortunately, it is virtually impossible to evaluate the specific effect of devaluation because of the development of other factors which have worked towards the same end. In other words, it is not possible to determine what the situation would have been over the past year if devaluation had not taken place, nor, on the other hand, what the effect of devaluation would have been without the large increases in the prices of internationally traded raw materials, or if there had been no Korean war and the resulting large scale rearmament. However, the devaluations must be reckoned as one of the factors in the improved trade position of the devaluing countries.

#### *Increasing import prices*

The third important factor contributing to the closing of the dollar gap has been the large increase in the dollar prices of important internationally-traded raw materials, which resulted largely from revival of economic activity and speculative demand in the United States and other industrial countries. The average price of United States imports turned sharply upward during the first seven months of 1950. The Department of Commerce index of the unit value of imports rose during this period from 217 to 241 percent of the 1936-38 average, while the index of export prices on the same base decreased from 182 to 176. The movement of both these indexes, therefore, indicates that price movements have contributed to the decrease in our export surplus. On the average, we had to pay 12 percent more for our imports in July as against last December, while at the same time we received 9 percent less for our exports.

It might appear at first glance that there is a contradiction between the last two factors which have been mentioned as contributing to our declining export surplus. Countries devaluing their currencies hoped to increase their dollar earnings by increased sales due to lower prices, but we find that one of the reasons for the declining value of our export surplus has been the higher price we

INDEXES OF AVERAGE PRICES<sup>1</sup> OF EXPORTS AND IMPORTS  
AND WHOLESALE PRICES—UNITED STATES, 1946-50  
(1936-38=100)



<sup>1</sup> Department of Commerce index of unit value. <sup>2</sup> All commodities.  
Source: United States Department of Commerce.

have had to pay for imports. This seeming inconsistency disappears, however, when we consider the nature of United States imports. By far the most important segment of our total imports is raw materials for which there are either no alternative domestic sources or inadequate domestic supplies. Owing to unprecedented levels of demand, we have been willing to pay the higher prices and at the same time take virtually all of these commodities which we can obtain. Devaluation, on the other hand, has benefited those countries which export products of a finished or manufactured nature which must compete with United States products. This latter group of countries consists primarily of the ERP countries.

#### Korea and rearmament

The last important factor which has helped to produce the rapid change in our trade balance has been the outbreak of armed conflict in Korea and the accelerated defense programs both in the United States and abroad. The effects of the Korean incident upon our international trade have been obvious and are well known. The outbreak of armed conflict has served to accelerate our Government program of stockpiling strategic raw materials that are obtained from sources outside the country. Not only has this stimulus increased the volume of imports, but it has served to accentuate the already rapidly rising prices of such internationally traded raw materials as rubber, tin, wool, ferro-alloys, and copper.

On the export side, available supplies of domestically produced goods have been diverted away from export markets into our rearmament program, as evidenced by the precipitous drop in exports in July. While the steep drop in our exports in July was not continued at the same rate in August, nevertheless, we can expect the supply of goods available for export to be restricted in the future, particularly as productive capacity is shifted into defense production. On the opposite side of the picture, an increase in our exports of military supplies to the Atlantic Pact countries and the Far East may be expected as

present plans reach fruition. However, whether or not these military shipments under our Mutual Defense Assistance Program will actually constitute a net increase in exports is questionable. Such military shipments may to a large extent replace other exports of a non-military nature. Under existing conditions, it may be difficult to satisfy our own domestic demand for civilian goods, and this will limit our ability to provide a surplus for export. The effect of the Korean incident was the last sharp squeeze that resulted in the closing of the dollar gap in August. In the months ahead, however, if world rearmament and particularly United States rearmament progress on the scale presently planned, this last factor will probably become the most important one in keeping the dollar gap closed.

#### The problem of continued foreign economic assistance

Thus far we have been concerned with the actual changes in our balance of trade and the contributing factors and have said little about the consequences of a greatly reduced export surplus or perhaps a continuation of an import surplus. Some of these consequences are already in evidence and the subject of considerable popular discussion; for example, our loss of gold, expanding reserves in other countries, and the revaluation of currencies. Other consequences of our changed trade position are yet to be realized and, therefore, are still matters of speculation.

Perhaps the most commonly discussed problem is the question of the position of ECA assistance in view of the rapidly growing dollar and gold balances in recipient countries. It is often contended that ECA has served its purpose of providing dollars to finance necessary imports until production can be restored to a point of self-support. The fact that our merchandise exports are now balanced by our merchandise imports is taken as proof that this point has been reached, and that further grants of dollars would serve merely to increase reserve balances in the hands of other countries. Our ECA program at present is scheduled to come to an end on June 30, 1952. It has been suggested that this date should be advanced.

A scaling down of ECA assistance will undoubtedly take place and, in fact, will probably be necessary in order for shipments of war materials under the Mutual Defense Assistance Program to take place on the scale planned. However, the contention that ECA grants are merely being used to build up reserve balances and, therefore, should be discontinued fails to recognize one important fact. This fact is that one of the objectives of the over-all United States policy, of which our ECA program is a part, has been to encourage greater convertibility of currencies as a necessary prerequisite for a growth of multi-lateral trade. Convertibility of currencies is impossible without adequate reserves of exchange and gold to carry countries through short-term exchange difficulties coincident with seasonal fluctuations in trade, temporarily depressed conditions in export markets, temporary short-

ages in raw materials, work stoppages of various sorts, crop failures, etc.

Unfortunately, it is practically impossible to set up hard and fast criteria to determine just what constitutes a safe reserve position, although present reserves for the most part appear to be much too small. For example, although the gold and dollar reserves of the United Kingdom have more than doubled since the devaluation (from a total of only \$1,340 million on September 30, 1949 to \$2,756 million on September 30, 1950) they are still far below their prewar level. In commenting on the adequacy of Britain's present reserves, Hugh Gaitskell, new Chancellor of the Exchequer, recently pointed out that prior to the war Britain's short-term liabilities and reserves were approximately equal. Today, however, short-term liabilities are more than four times as large as total reserves. The figure most commonly mentioned as being the minimum necessary to provide full convertibility of sterling is \$5 billion, which even under the present very favorable conditions still leaves a long way to go. The danger in the present situation is that we do not want to jeopardize the billions that we have spent to rehabilitate world trade by pulling the stops before the benefiting countries are in a sound enough reserve position to weather the normal ups and downs of international trade. If the decision to cut off all economic assistance is taken too soon, it is possible that the first minor storm which comes along will result in a panic and a wholesale resort to trade restrictions. This would mean a contraction of trade and a virtual cancellation of the accomplishments that have been made as a result of ECA. Or perhaps even more frustrating, if ECA assistance is suddenly terminated, it might immediately arrest the present momentum towards convertibility and the growth of multilateral trade. Today, with the dollar gap no longer presenting a major obstacle, convertibility has become a practical possibility. However, with a discontinuation of ECA grants, recipient countries may feel that their reserves are inadequate and seek to protect them by adopting restrictive measures, thus moving in the opposite direction from that which is desired. Our changed trade position certainly makes possible a reduction in the burden imposed by our program of foreign economic aid, but the cuts should not be applied on such a scale as to endanger our investment.

### **The loss of gold**

The improving reserve position of foreign countries has been reflected in part in gold losses by the United States. During the earlier postwar period, the United States had been consistently an importer of gold, and imports of gold reached a peak of \$2,850 million in 1947. After the peak year 1947, imports of gold decreased as the dollar gap decreased until finally in September 1949 we became a net exporter of gold. Our exports of gold, however, were relatively modest until the outbreak of hostilities in Korea, averaging approximately \$45 million a month. In July 1950, our gold loss increased to \$90 million and in August

climbed to \$494 million. The large loss of gold in August, however, has apparently marked the peak; preliminary figures on the basis of weekly data indicate that the outflow was reduced to \$278 million in September and for the first three weeks of October to \$183 million. For the year ending August 31, 1950, our total gold loss amounted to \$1,026 million and for the entire period of gold loss (including the weekly data for September and through the third week of October) it amounted to \$1,487 million.

In spite of this comparatively large loss of gold, the total United States gold stock on October 18, 1950, amounted to \$23,291 million or approximately 70 percent of the world's total known monetary reserves. In referring to our loss of gold it should be noted that most of this gold actually has remained in the United States earmarked for foreign account at Federal Reserve banks.

While the effect of this loss of gold has been to increase the monetary reserves of foreign countries, it should not be assumed that it constitutes the counterpart of a United States import balance of merchandise trade. A glance at the previously mentioned figures will reveal that we were losing gold while at the same time our merchandise trade showed an export balance. To some extent ECA dollars have enabled foreign countries to purchase gold. In the United Kingdom, for example, for the quarter ending September 30, ECA dollars accounted for \$147 million of the total increase in reserves of \$187 million, a large part of this increase in reserves taking the form of gold purchased in the United States.

Some of our gold loss may also be explained purely in terms of capital transactions, that is, an exchange of other foreign held dollar assets for gold. It is possible only to speculate as to motivations behind such transactions. To a certain extent they have been of a speculative or panic nature. Capital transactions of this nature are common to all periods of war panic and the Korean incident has been no exception. As typical of this sort of transaction we might mention rumors that Americans and foreign holders of dollar assets, fearing increased taxes, governmental controls, and inflation in the United States, have sold dollars to obtain foreign assets. These dollars may have been used in part to purchase gold. Rumors of an appreciation of the Canadian dollar reportedly brought about movements of speculative capital from the United States to Canada prior to the freeing of that currency from its official parity with the United States dollar. This may also have contributed to our gold loss. Similar movements in response to rumors of revaluations in Australia, Mexico, and the United Kingdom have been taking place, but their magnitude is not known.

Further, the flow of private investment capital from the United States, as contrasted to purely speculative movements, has enabled certain governments to increase their gold stocks. This has been particularly true in the case of Canada, the countries of the Near East, and Latin America.

### *Revaluation of foreign currencies*

A further international monetary development that has been closely connected with the closing dollar gap is the appreciation of the Canadian dollar and the rumors of upward revaluations of certain other currencies, primarily the pound sterling and the Australian pound.

Canada announced on October 2 that the Canadian dollar was to be freed from its official parity with the United States dollar of 91 cents, to seek its own level in response to the forces of supply and demand in exchange markets. Prior to this action there were persistent rumors that Canada would restore the Canadian dollar to equal parity with the American dollar. To have established an official equality with the dollar would have overvalued the Canadian dollar, as shown by the fact that in a free market the Canadian dollar has been fluctuating around 95 cents to the United States dollar.

Canada's decision to let her dollar appreciate was made possible by her rapidly declining merchandise import deficit with the United States, as has been pointed out earlier, and by her rapidly increasing reserves of dollars and gold. Canadian exports to the United States have increased approximately 36 percent during the first eight months of 1950. During the same period Canada's reserves of dollars and gold have increased by \$534 million since June 30 and by \$285 million during the month of September alone. As of September 30 Canada's total reserves amounted to \$1,789 million as compared with \$985 million a year ago.

Canada's decision to appreciate its currency apparently was motivated by two primary considerations. It probably was taken as an anti-inflationary measure and also as an effort to turn the terms of trade in favor of Canada. While a great deal of that country's recent inflow of capital has been in the form of long-term investment, part of it has been speculative in nature. Commenting on this problem, Canadian Finance Minister Abbott made this statement: "An influx of funds on this tremendous scale would, if it continued, be likely to exercise an inflationary influence in Canada at a time when government policy in all fields is directed to combating inflationary developments."

Canada's efforts to turn the terms of trade in her favor by an appreciation of her currency reflects her confidence in a continued strong demand in the United States for her exports. In view of the nature of our Canadian imports, such confidence would appear to be justified. Our most important imports from Canada consist of lumber and lumber products, ferro-alloys (of which nickel is the most important), and animals and animal products. All of these commodities, while always important to our economy, have assumed increased importance in view of our present military development program. With this favorable outlook, Canada apparently feels that she can obtain more favorable terms of trade. By appreciating her currency Canada, in effect, is raising the prices of her exports expressed in United States dollars while at the same time

reducing the price, expressed in her own currency, that she must pay for her imports. Thus, for a given volume of exports to the United States, Canada will be able to obtain a larger volume of imports from the United States.

In the case of other rumored appreciations of foreign currencies against the dollar, the factors making such moves feasible and the motivations are similar to the Canadian situation. The position of the United Kingdom cannot be considered to be as favorable as that of Canada. Nevertheless, the United Kingdom's unfavorable terms of trade which require her to send out one-eighth more exports for a given volume of imports than she did before the devaluation have become increasingly burdensome. She has had difficulty in producing sufficient goods to meet export demands and this difficulty will undoubtedly increase as her defense program is expanded. At the same time, increasing prices of imports will have to be translated into increased retail prices. The wage front is also becoming increasingly restless, thus further contributing to inflationary pressures.

Australia's position appears highly favorable in view of an export surplus with the United States of \$15 million for the first seven months of 1950. A recent \$100 million loan by the International Bank will increase the supply of available exchange. In the case of the flow of speculative funds in anticipation of some upward revision in the value of the Australian pound, there has been some forward buying by American businessmen with future Australian claims to meet. The inflow of British speculative capital in Australia has been more important, however. Australia's improved position reflects in part the favorable prices which she is obtaining for her current wool clip. Latest estimates, with the price of wool 40 to 50 percent above last year, are that Australia will realize £A 450 million from wool exports this year as against £A 250 million last year. An additional factor adding to the possibility of some revision in the value of the Australian currency is the fact that while the purchasing power of the Australian pound is at least as great as that of the pound sterling it is nevertheless quoted at a 20 percent discount under sterling.

### *How strong is the dollar?*

As a result of the closing of the dollar gap, our recent loss of gold, and the actual or rumored appreciation of other currencies against the dollar, there has been a rash of pessimistic articles declaring that the dollar is deteriorating and that a "flight from the dollar" is developing. Since this decline is relative to other currencies, it does not necessarily indicate a lack of confidence in the dollar so much as it demonstrates growing confidence in other currencies. In other words, the present situation is a reversal of that which prevailed just prior to the devaluations in 1949. At that time, the relative value of other currencies to the dollar had been deteriorating rapidly and the devaluations recognized this situation. Today because of improved conditions in many foreign countries,

and in particular the sterling countries, as indicated by a more favorable balance of payments position and growing reserves, there has been a restoration of confidence in these currencies.

### Conclusion

To sum up, there is no basis for fears as to the present strength of the dollar. Our underlying balance of payments situation is still strong in spite of the August deficit which would have been impossible without the artificial restrictions placed by other countries against American imports. Our monetary gold reserves still account for 70 percent of the world's total reserves. Psychologically, the dollar is still the world's strongest currency and there can be little doubt that the present so-called "flight from the dollar" would be quickly reversed if all exchange controls were abolished throughout the world.

It is even more difficult to view the present world trade situation pessimistically when it is realized that the United States has been working since the end of the war to produce the very conditions that are at present developing. We have spent \$10 billion through ECA assistance in our efforts to close the dollar gap and to restore convertibility of world currencies. Today with world trade approaching a balanced position and with growing reserves behind other currencies we are at last reaching a point where convertibility and a growth of multilateral trade are becoming practical possibilities.

While there does not appear to be anything in the present situation which would cause us to fear for the strength of the dollar, there are, nevertheless, dangers in the near future. There is no doubt that the United States will continue her support of the United Nations fight against Communist aggression and that she will bear the bulk of the military and economic effort, just as she has in Korea. Our defense expenditures will far outstrip those of any other member of the United Nations. The result will be a continued large scale importation of strategic materials, a diversion of our industry away from civilian to defense production, and a reduction of our ability to export. In addition, the flow of dollars to the rest of the world for economic and defense assistance is expected to continue on a large scale. We have earmarked \$5.2 billion for our Mutual Defense Assistance Program, and Economic Cooperation Administration program, while reduced by \$900 million below original estimates, calls for an additional \$2.2 billion.

There can be little doubt that the economic burden indicated by present plans will severely tax our economic capacity. The inflationary pressures that may be generated do foreshadow grave dangers for the dollar. Should we be unable to keep inflationary developments under control, and should inflation in the United States proceed at a faster rate than elsewhere in the world, the value of the dollar vis-à-vis other currencies would in all probability deteriorate.

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### WAYWARD FRUIT PRICES

**F**RUIT is not a very important contributor to total agricultural income in the United States. Between 1946 and 1949 the fruit industry supplied only about 5 percent of the nation's total cash farm returns. To the agricultural economy of the Twelfth District, however, fruit is of special significance. A major share of the nation's output is concentrated in this area. From 1946 to 1949, 56 percent of the nation's yearly average cash farm receipts from fruit and nut marketing came from District orchards, and within the District over 22 percent of total cash farm income was derived from fruits and nuts.<sup>1</sup>

Of the major fruits, only three are of importance in states outside the Twelfth District; namely, apples, peaches, and citrus. Peaches are grown in 40 states and the production of apples is almost as widely distributed. On the other hand, prunes (both fresh and dry), apricots, and lemons are produced exclusively within the District. California, Oregon, and Washington consistently account for approximately 85 percent of the national output of grapes, pears, plums, and figs. Fluctuations in prices received by growers for fruits, therefore, exert a significant influence on the cash income realized by District farmers, with growers from the Pacific Coast states the primary victims or beneficiaries.

<sup>1</sup> Percentages include receipts from nuts which are a relatively small part of total fruit and nut receipts.

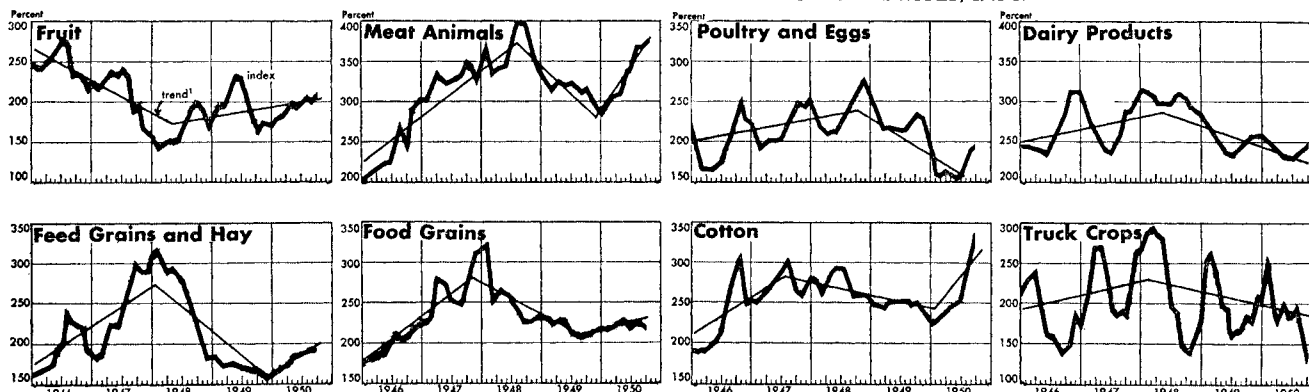
A general similarity of movements has been evidenced in the pattern of fruit prices during the postwar years. This pattern, however, has been very different from price movements of other major farm commodity groups—food, feed, fibre, truck crops, and livestock and livestock products. Fruit prices were the only group of farm prices in 1947 to fall from 1946 levels and, conversely, the only agricultural price group to rise in 1949 from the previous year's level. On the other hand, between 1946 and 1949, the price index of food and feed grains, cotton, and truck crops increased the first year, only to be followed by two successive years of decline. Average prices for livestock products meanwhile worked upward during 1947 and 1948 before starting to decline in 1949. During 1950, however, fruit prices have accompanied the general upward movements of other farm commodity prices.

#### Citrus fruit

Between 1946 and 1949, citrus prices followed the general movement of the fruit price index. Average prices received by growers for oranges in 1947 in the nation as a whole dropped 46 percent below 1946 and were further depressed 20 percent in 1948, before turning upward the following year. Within the Twelfth District, price fluctuations for citrus fruit varied considerably. While California orange prices in 1947 declined at about the same



## INDEXES OF PRICES RECEIVED BY FARMERS—UNITED STATES, 1946-50



<sup>1</sup> This line represents a free-hand smoothing of the fluctuations to point out the major directions these prices have taken over this period.

Source: United States Bureau of Agricultural Economics, *Agricultural Prices*.

rate as the national average, fruit from Arizona groves declined only one-third as much. The following year, when average orange prices in California were further reduced 9 percent, prices received by Arizona growers were down 45 percent. With the upturn in 1949, however, Arizona prices rose 73 percent as against 8 percent in the United States and 10 percent in California.

Prices received by growers for lemons, which are grown almost exclusively in California, declined in 1947 and again in 1948 at approximately the same rate as California orange prices, but rose over 70 percent in 1949. Prices received by growers for grapefruit both within and without the District were down in both 1947 and 1948, though less pronounced in California than in Arizona. The later price rise, however, was approximately equal in both states.

These price fluctuations experienced by citrus fruits in the postwar period have been essentially a reflection of supply and demand conditions. The reduction in exports has not been so influential a factor on the price level of citrus fruits as it has been on prices of some other fruits during the past few years. Before the war, approximately 35 percent of the nation's dried fruit production and 14 percent of its canned fruit production found an outlet in foreign exports, while between 1935 and 1939 only about 7 percent of domestic orange production was exported. A large share of these exports, however, were absorbed by the Canadian market, which for all practical purposes, the citrus industry considers a part of the domestic market.

The consumption of citrus, both fresh and processed, has increased greatly, and the increase in the use of frozen and processed citrus juices has been particularly outstanding. In 1945-46, when frozen orange juice was first introduced, it created an outlet for only one-fifth of 1 percent of the crop. By 1948-49, over 10 percent of the crop found a market in this form. Frozen concentrate juice is so far a more important outlet for Florida citrus than for the Twelfth District crop. Production of frozen orange concentrate in the District, however, did not get started until 1947-48. Of the 12 million gallons of concentrated orange juice produced in 1948-49, 20 percent came from California and Arizona fruit. In company with these increases

in the use of citrus fruit in both fresh and processed form over the past decade, citrus production, particularly oranges and grapefruit, has also been greatly increased. Production increases, accelerated during the past decade, culminated in record crops in both 1947 and 1948. The drop in prices received by growers during these years reflected this increase in supply. The drastic freeze in District groves and inclement weather in Texas and Florida citrus areas in the winter of 1948-49, however, resulted in a short citrus crop. Average citrus prices in 1949 reflected this crop reduction; growers received 36 percent more for oranges, 71 percent more for lemons, and 56 percent more for grapefruit.

During the first four months of 1950, the monthly average price for oranges has been at higher levels than in 1949. Between May and August, prices averaged below last year, but again rose above 1949 levels in September. Carry-over stocks of canned orange juice at the beginning of the new pack season this fall were reported at very low levels, and it is expected that strong demand will be made on this year's crop to replenish the supply.

#### Pears and apples

Prices received by growers in the Twelfth District for both pears and apples since 1946 have reflected the basic relationship between supply and demand. Price declines in 1947 accompanied increases in total production. The following year as District output fell 25 percent for both crops, prices received by growers advanced 25 percent for pears and 10 percent for apples. Growers received drastically lower prices again in 1949, however, as orchards brought forth bountiful crops.

The fluctuations in both United States and District average prices received by growers obscures the fact that actual cash farm receipts for fruits are apt to suffer more in some localities than in others from price fluctuations. Average pear prices, for example, for the United States as a whole dropped 53 percent in 1949 below the previous year's level. Average prices to growers meanwhile were down 71 percent in California and 56 percent in Washington, but only 24 percent in Oregon. The sharper reductions in California and Washington prices were due to



the greater decline in prices received for Bartlett pears as contrasted to other varieties. Other varieties are marketed principally in fresh fruit channels—an outlet faced with fewer marketing problems in 1949 and in which price declines were, therefore, less drastic.

Bartletts are primarily a canning fruit and factors in the canning industry exert a significant influence on average prices paid to growers. In 1949, the carryover of the previous year's pack was large. The situation was later aggravated by the Hawaiian longshoremen's strike which delayed pineapple shipments to West Coast packers. As both pears and pineapple are essential ingredients in the fruit cocktail pack, the uncertainty of the pineapple supply resulted in a slow-up of demand for Bartlett pears. In 1949, production of Bartletts was up 40 percent over 1948 in California and more than 50 percent in Washington. On the average, this variety accounts for approximately 87 percent of all California pears and 73 percent of the Washington crop. It is readily seen why average prices received by pear growers in these two District states were so much more depressed than in other pear-producing areas where this canning pear is not so important.

In 1947, in response to a bumper harvest, average annual prices received by apple growers over the nation as a whole were 28 percent below 1946 levels. This was approximately equal to the general price decline in most District apple growing areas. In California, however, prices dropped nearly twice as much. The following year, a short crop was reflected in appreciable price advances throughout the major commercial producing districts. A larger than usual hold-over of cold storage stocks from the previous year's output and restricted export demand dampened what otherwise might have been more substantial price increases. As could be expected, carryover stocks at the end of 1948 were small—40 percent below a year earlier. With a 50 percent increase in 1949 production (23 percent over the 1939-48 average), apple growers again felt the effects of drastic price reductions—30 percent under 1948 levels. In 1950 however, some increase in average annual prices may be registered over 1949. Preliminary figures indicate a 12 percent decrease in total production, and carryover stocks from last year's harvest were only slightly higher than the 1945-49 average. Though these stocks had some dragging effect on prices during the early months of the year, fall prices will probably average out above last year as a result of the reduced output.

California apple growers frequently suffer more drastic price reductions on a decreasing price trend than do growers in other major commercial apple growing areas. As is the case with pears, this is the result of the relative importance of different varieties. Approximately a third of California's production consists of the Gravenstein variety, and this state also produces 93 percent of all Gravensteins grown in the nation. This California specialty is the nation's leading summer apple, a variety first developed for the purpose of supplying the nation's mar-

ket basket at a time of fresh fruit scarcity. The introduction of refrigeration and cold storage made possible both the nationwide marketing of soft fruits during the summer and the sale of other apple varieties the year round. The favored position of this summer crop was consequently undermined. Gravenstein prices declined 70 percent in 1947 compared to 47 percent for all California apples and 27 percent for all United States apples. Subsequently, however, price declines for this variety have not exhibited such disparity.

Per capita consumption of apples has fallen sharply over a long period of time. Between 1910 and 1920 average consumption of apples amounted to 63 pounds per person. In the period 1940-48 it had dropped to only 26 pounds. In contrast to this sharp drop in apple consumption, production has dropped only one-fourth. Prices received by growers, therefore, are now vastly more sensitive to yearly production changes, and marketing problems are made more difficult.

### **Peaches**

Peach prices have fluctuated considerably since the war, dropping in 1947, increasing in 1948, declining again in 1949, and rising again this year. This price pattern was evident both for the clingstones raised in California and the freestones raised in all District states. Clingstones are utilized almost entirely for canning, so that the prices paid growers are dependent upon the size of the crop, the stocks of canned peaches on hand, and the demand for canned fruit and canned peaches in particular. In 1947, the clingstone crop was smaller than the 1946 crop, but canners paid growers less. The Government's large military purchases had ceased, export demand was small, and the supplies of all fruits were large. The following year the crop was again reduced, pushing prices back up to the 1946 level. The 30 percent drop in prices to growers in 1949 stemmed largely from the pressure of the largest crop of clingstones on record. At the same time, large carryovers of canned peaches and fruit cocktail put further pressure on prices. This year, stocks were considerably lower and the crop turned out about 17 percent smaller. Grower prices for the No. 1 grade fruit being canned are up 50 percent.

In contrast to clingstones, most freestone peaches are marketed fresh. In addition to the size of the District crop, the size of the peach crop in the Southern states which compete with District peaches for the eastern market, and consumer demand for all fresh fruit are important price making factors. Since the war, the principal price determinant has been the size of the peach crop, both in the District and in other competing states. The price declines in 1947 and 1949 accompanied large crops. In 1948 and again this year, smaller crops brought larger returns to growers.

### **Grapes**

Few other fruits suffered so sharp a price decline in the postwar years as did grapes. From a record high price

of \$90.50 per ton for all varieties in 1946, returns tumbled 60 percent in 1947. Grower prices remained at this low level in both 1948 and 1949, and have just recently shot up again to over twice the 1948 and 1949 level. Such extreme price fluctuations have plagued the grape industry over the last decade and clearly illustrate the peculiar and complex grape problem.

From 1931 to 1946, District production (almost entirely in California) of all varietal classes of grapes increased steadily, more than doubling during the entire period. This increase was due almost entirely to an increase in the yield per acre since bearing acreage has remained fairly constant. Since 1946, production has decreased gradually each year, with the 1950 estimated output being the lowest since 1942. The fact that prices remained at lower levels in the face of these smaller crops points out the complexity of the industry. Many varieties of grapes, whether they are wine, table, or raisin varieties, can be utilized in one or both of the other outlets. Consequently, the supply and market conditions for either wine, raisins, or table grapes exert a strong influence on the prices growers receive for the other varietal types.

The large 1946 output of grapes was mainly reflected in swollen inventories of wine. A few months after the size of the crush became known, wine prices broke sharply. By harvest time in 1947, with the crop only slightly smaller, wineries were offering growers only \$30 per ton compared to the \$90 paid in 1946. It was not until the short crush of 1949 that wine prices began to improve. During the three years of low prices, from 1946 to 1949, conditions in the raisin segment of the industry also contributed to low grower returns. After the large diversion of grapes to wine in 1946, 1947 saw the largest peacetime raisin production in history. But the important prewar export market was restricted and the Government had ceased its military purchases. Even though the Government bought 40 percent of the raisin crop in 1947 and 30 percent in 1948 to ease the surplus situation, stocks were excessive for commercial needs and prices remained at low levels. This year with packers raising their opening prices on raisins, grower prices have more than doubled.

#### **Prunes and plums**

Conditions in the District's dry prune industry have been similar to those in the grape industry. Grower prices, which had reached a peak in 1946, fell over 40 percent in 1947 and remained at this low level for the next two years. After the large crops of 1945 and 1946, supplies became burdensome, especially since the very important export market was lost. Production decreased each year beginning in 1947, and the 1949 crop was the smallest since 1929. Supplies still remained excessive, however, and prices were largely determined by marketing programs and various forms of Government assistance. The Government purchased 62 percent of the total District crop in 1947 and 37 percent of the 1948 crop. Though grower prices in 1949 were up only slightly over 1947 and 1948

levels, market conditions were generally improved and supplies were not excessive. With a slightly smaller crop again this year, and with marketing programs limiting the saleable quantities, grower prices are up three to four cents per pound over the 1949 prices.

Plum prices have differed from dry prune prices in their behavior since the war. Grower prices rose moderately in 1947, remained steady in 1948, and then declined 50 percent in 1949. Since plums are largely marketed as fresh fruit, plum prices depend principally upon the supply of plums and upon the supply and prices of competing fresh fruit. During the last four years plum prices have moved in the opposite direction from production changes, and this relationship is evident again this year. Plum prices are up from last year and production is down. The 25 percent increase in prices growers have been receiving on the Eastern markets, however, is also due to the small crop of Southern peaches, which generally compete with plums on the early market.

#### **Apricots**

The loss of the important export market and the general dullness in the demand for all dried fruits have had a marked influence on the postwar market for District apricots. Grower prices declined from 1946 to 1948 in spite of a drop in production of almost 50 percent in 1947, and remained at this lower level in 1949. Until recently, drying has been the most important outlet, but canners are now taking larger and larger percentages. The prewar importance of the export trade is shown in the fact that exports averaged 50 percent of the 1935-39 output of dried apricots. Only about 10 percent of the 1949 production was exported; in addition, the total out-turn of dried apricots last year was slightly less than the average quantity exported in prewar years.

Apricot growers have received slightly higher prices for this year's crop, even though it was larger than the 1949 crop. Fresh shipments out of state were considerably larger than last year because of severe freeze damage to fruit in other states. Since cannery demand has also been active, the market for all utilizations has been much stronger than last year.

#### **Complex factors affect prices**

This brief analysis of postwar District fruit prices points up the complexity of the factors which influence the prices fruit growers receive for their crops. As with most agricultural commodities, farm prices for fruit are not determined solely by the size of the crop or the income of consumers. The size of competing crops in other areas, trends in per capita consumption, the demand for canned fruits, the amount of dollar exchange in the hands of importing countries—all these may at one time or another affect the price for a particular District fruit crop.

Most of these factors played a part in the decline in fruit prices which began in late 1946. Production of most District fruit crops had been increasing during the war, reaching a peak in 1946. Though the 1947 crops were

somewhat smaller, production totals were still large. At the same time, with price controls and rationing ended, other foods became more readily available. The weaker tone in the canned fruit market was also important. The year 1946 had seen a record canned fruit pack in the District and the 1947 pack was second only to 1946. By the middle of 1947 with cannery stocks double those of a year earlier, canned fruit prices had weakened. These two conditions naturally affected the prices canners were paying to growers.

The postwar loss of export markets was a serious one to many District and national fruit growers. Prewar export markets took about 11 percent of our national production of fresh fruit, about 35 percent of our dried fruit, and 14 percent of our canned fruit. World War II left European countries without purchasing power to buy fruits, which further depressed many fruit prices, particularly those which were largely dried. In addition, the problem of the dried fruit industry has been increased by the apparent impossibility of increasing the domestic per capita consumption of dried fruits. Per capita consumption has remained consistently between 5 and 6 pounds over the last thirty years.

These factors were primarily responsible for the downturn in fruit prices from 1946 to 1948, while the prices of

most other agricultural commodities were turning upward and national income was increasing. The pressure of large crops had been felt in the fruit industry in 1946 and 1947, but it was not until 1948 that this condition affected the other agricultural industries. During 1948 and 1949, prices of most agricultural commodities, except fruit, declined sharply in the face of large supplies. In the fruit industry, however, many of the price depressing influences had been partially overcome and prices recovered some from their low levels of the previous years. The size of many fruit crops, particularly in 1948, were smaller than in 1946 or 1947. In addition, marketing programs, Government subsidies, and purchases by the Government of substantial quantities of some crops tended to remove surplus supplies from the market.

The divergence of fruit prices from the pattern of other agricultural prices may have come to an end in 1949. So far this year, most agricultural commodity prices including fruit prices have been moving upward. Smaller crops have been largely responsible though the inflationary tendencies of our whole economy have made their influence felt. Fruit prices will probably continue to follow much the same pattern as other agricultural prices, but the various complex factors which were so influential during the 1946-49 period are still important and make price predictions difficult.

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### WHAT IS HAPPENING TO THE BUYING SPREE

**I**T looked like the pre-Christmas season at retail stores during July and August—at least in terms of sales volume. Shoppers started crowding the stores shortly after the outbreak of fighting in Korea on June 25 and bought heavily throughout July and the first week of August. The heavy buying eased during the second week in August and since then increases over last year in total retail sales have been within more reasonable limits.

In July, the dollar amount of total retail sales in the United States jumped about 20 percent above the July 1949 volume. The increase in August was only slightly less. Shoppers concentrated their buying efforts at durable goods stores. Sales of building materials increased the most over the comparable months in 1949 (over 40 percent in both July and August), while the increases in house furnishings sales were second highest. Automobile sales also increased considerably under the impact of scare buying. Nondurable goods stores, offering fewer items on the scare list, had only moderate increases in July and August. Sales at department stores, which sell both durable and nondurable goods, were up 30 percent in July and 18 percent in August. Although the buying spree slackened during August, total retail sales during September were still well above the sales of the same month last year. As during July and August, sales of building materials and house furnishings during September increased the most over last year. Nondurable sales were up, but by less than 10 percent.

Moving up with sales were prices charged customers for house furnishings at retail stores throughout the nation. In August, house furnishing prices were 2.4 percent higher than in August 1949, and in September, 5.3 percent above September 1949. Apparel prices increased slightly from July to August, but in August were still about 1 percent below those of August 1949. In September, however, apparel prices increased 1.8 percent above the September 1949 level. Complete sales data are not available for all retail businesses in the Twelfth District, but the figures that are available—for department, apparel, and furniture stores—indicate a similar behavior in District retail sales.

#### *United States total retail sales rose in the first half of 1950—before Korea*

United States retailers could have expected sales to have been at a reasonably high level last summer even without the sudden demand created by the Korean War. Although total nonagricultural employment in the country was down during the first four months from a year ago, in May and June it exceeded last year's level. For the first half of this year, compared with the first half of 1949, personal income was up slightly, average hourly earnings of manufacturing employees were up 4 percent, and total residential construction activity—which directly affects house furnishings sales—was up almost 50 percent. Total retail sales for the period were about 5 percent above the first half of 1949. Sales at department

stores, however, lagged 4 percent behind the comparable period of 1949. The difference between total retail sales and department store sales was caused by the large increases in sales of automobiles and building materials, items not handled by department stores.

**District department store sales in first half nearly matched last year's sales**

In the Twelfth District, department store sales during the first half of 1950 were only slightly below those of the first half of 1949. Total dollar sales, adjusted for seasonal variation, were at a low level in January, compared with other post-war Januarys. In February they rose only slightly, then leveled off in March. During the next three months, however, dollar sales rose steadily to reach a high level in June. During this period shoppers bought more durable and less nondurable goods than during 1949. Dollar sales of piece goods and household textiles, women's clothing, and the basement items (mainly clothing) totalled less each month from January through June than during the comparable months of last year. Sales of small wears (toilet articles, silverware, jewelry, etc.) fell behind 1949 in each month except May. Sales of men's clothing and women's accessories, however, showed small increases. Nearly offsetting the decreases in most soft goods departments were consistent increases in sales of house furnishing items. Increases in sales of furniture, rugs, and major appliances reflected the large increases in residential construction this year. The large increases in sales of the radio-phonograph-television department reflected for the most part a very heavy demand for television sets.

**Twelfth District department store sales rise sharply after June**

The panic buying at Twelfth District department stores was concentrated in the period from July 8 through August 5, except for a large increase during the week ending September 16. For the country as a whole the buying spree was of somewhat longer duration, but was not so extreme as in this District. It is estimated that sales of major appliances—refrigerators, stoves, etc.—in the District during the week ending July 22 were more than four times greater than those of the comparable

week of last year. The increase in total sales for the week ending September 16 was largely the result of widespread use of the easy credit terms during the week before the reinstatement of Regulation W on September 18. For the weeks from August 6 through September 30, however, the year-period sales increases were moderate—ranging from 6 to 11 percent. For the weeks ending October 7 and 14 District sales were up only slightly, and for the week ending October 21, Twelfth District sales decreased 2 percent, compared with the corresponding week of the previous year.

Most of the departments affected by the scare buying (see table) experienced substantially smaller increases in August and September than in July. In general, shoppers did not seek out the lower-priced items, but bought indiscriminately. Evidence of the nature of buying is apparent from the fact that most basement store departments increased less than the comparable departments in the main store. An interesting sidelight can be found in the sales of women's inexpensive dresses compared with sales of better dresses. Sales of inexpensive dresses increased only slightly in July and in August dropped 5 percent from a year ago. Sales of better dresses, however, were up 8 percent in July and 10 percent in August over the same period last year. In September, sales of inexpensive dresses were up 1 percent and better dresses were up 15 percent.

The fear of shortages and possibly of price increases and installment buying regulations during July and early August centered the buying spree at the durable goods counters of department stores. This accentuated the shift from nondurable goods sales to durable goods sales which had taken place during the first half of the year. In July and August 1949, nondurable goods accounted for about 68 percent of Twelfth District department store sales and durable goods, about 32 percent. During the same period this year the percentage of nondurable sales fell to about 65 percent and durable goods sales increased to about 35 percent of total sales.

Total department store sales were up over last year in all areas of the District. In July, sales in Bellingham, Washington, increased 76 percent—more than in any other District city. Two other cities, Fresno and Sacramento, had increases above 50 percent. In August and September, all District cities showed increases, though the gains were not so large as in July. Bellingham again had the largest year-period increases in the District in both months.

**Installment sales rise sharply prior to reimposition of Regulation W**

Department store customers paid for their July and August purchases with less cash and more credit than ever before. Installment sales in July were over 100 percent above those of July 1949. Cash sales were up only 13 percent. In August, installment sales were up 33 per-

**TWELFTH DISTRICT DEPARTMENT STORE SALES BY SELECTED DEPARTMENTS**

Percent change, July, August, and September 1950 compared with the same months last year

	July	August	Sept.
Linens (including towels) .....	+ 53	+18	+ 13
Domestics, muslins, sheeting .....	+257	+85	+ 86
Blankets, comforters and spreads...	+ 64	+25	+ 30
Women's hosiery .....	+153	+16	- 1
Knit underwear .....	+ 62	+ 9	+ 12
Furniture and bedding .....	+ 59	+33	+ 33
Domestic floor coverings .....	+ 50	+47	+ 43
Major household appliances .....	+239	+29	+ 39
Radios, phonographs and television.	+114	+94	+106
<b>Total sales .....</b>	<b>+ 38</b>	<b>+12</b>	<b>+ 15</b>

RATIO OF COLLECTIONS DURING MONTH TO ACCOUNTS RECEIVABLE AT BEGINNING OF MONTH—TWELFTH DISTRICT DEPARTMENT STORES

	Regular charge		Instalment	
	1950	1949	1950	1949
May .....	53	54	18	23
June .....	52	54	17	23
July .....	52	53	18	21
August .....	52	54	18	22
September .....	52	53	19	20

cent and cash sales 4 percent. September installment sales increased 35 percent and cash sales 6 percent, compared to the same month in 1949. Estimates of weekly sales indicate that the largest increases in installment sales in this District came during the weeks ending July 22, 29, August 5, and September 16. Department store sales are normally on a cash and charge basis with only a small percent of total sales on an installment basis. Of each dollar spent at District department stores in 1949, 47 cents were paid in cash, another 47 cents were charged, and 6 cents paid in installments. To pay for the large increases in purchases of high-priced items such as stoves, refrigerators, and television sets, shoppers made very extensive use of easy credit terms in the period after the Korean conflict started. July installment sales jumped to 10 cents per dollar spent, regular charge sales increased only slightly to 49 cents of each dollar spent, and cash sales dropped to 41 cents of each dollar spent. In both August and September the comparable amounts were installment sales—9 cents, charge sales—48 cents, and cash sales—43 cents.

The large dollar volume spent at department stores during July, August, and September did not slow down the collections of the amounts owed by customers using credit. The collection ratio, which indicates the percentage of total amounts owed at the beginning of the month which were paid off during the month, was in fact slightly higher for installment sales in July than in June. Compared with last year, however, collections were down considerably.

**Twelfth District department store stocks and orders outstanding: first half of 1950**

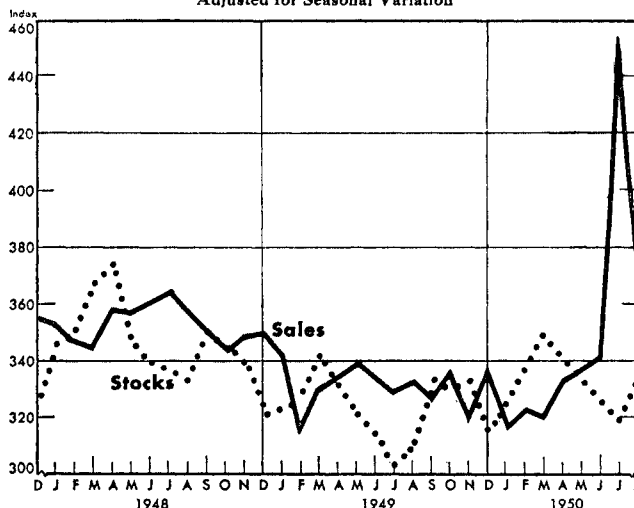
The dollar value of stocks held by department stores rose from January to March on a seasonally adjusted basis, but then decreased steadily to June. During this period stocks were at a slightly higher level than in the comparable months of 1949. Orders outstanding during the first two months of this year were at about the same level as the year before, but the seasonal decline in March, April, and May was not so great as last year. By the end of June, the stores increased their orders nearly 30 percent in anticipation of the buying spree.

The stocks held by department stores did not follow the shift from nondurables to durables experienced in sales during the first half of the year. Instead, nondurable stocks were generally up and durables were down. This was caused by several factors: the failure of anticipated increases in nondurable sales this year to materialize,

INDEXES OF TWELFTH DISTRICT DEPARTMENT STORE SALES AND STOCKS

(1935-39=100)

Adjusted for Seasonal Variation



especially during the Easter season, thereby increasing nondurable stocks; a high level of durable goods stocks during the first half of last year; and the difficulties of getting deliveries of certain durable items even before the Korean war.

**Twelfth District department stores increase stocks and orders after June**

Although hit by unexpectedly heavy sales in July, department stores found themselves in a reasonably well stocked position at the end of July. In anticipation of further increases in sales and to stock up against shortages, they placed large commitments. Orders outstanding at the end of July were 70 percent above, in August 67 percent above, and in September 30 percent above the corresponding months of 1949. Stocks declined appreciably in only a few of the heavily hit departments during July compared with the same period last year, though stocks for a number of departments decreased moderately. In August and September, stocks in most of the heavily hit departments were above those of the same period last year.

TWELFTH DISTRICT DEPARTMENT STORE STOCKS BY DEPARTMENTS  
Percent change, July, August and September, 1950 compared with the same months last year

	July	August	Sept.
Linens (including towels) .....	- 5	+12	+29
Domestics, muslins, sheetings .....	-32	-28	+ 6
Blankets, comforters and spreads .....	- 4	+ 9	+31
Women's hosiery .....	-16	+44	+70
Knit underwear .....	+ 3	+25	+33
Furniture and bedding .....	- 4	+ 4	+14
Domestic floor coverings .....	+10	+23	+37
Major household appliances .....	-45	-15	+ 2
Radios, phonographs and television...	0	+13	+47
Total stocks .....	+ 2	+10	+16

*Correction:* A chart on page 107 of the September issue of the MONTHLY REVIEW is entitled "Insured employment, July." The correct title should read "Insured unemployment, July."

## RECENT DEVELOPMENTS IN CREDIT REGULATION

### Residential mortgage credit

Pursuant to the Defense Production Act of 1950, the Board of Governors of the Federal Reserve System issued Regulation X, effective October 12, governing credit on new residential construction. Simultaneously, revised credit terms governing mortgages insured by the Federal Housing Administration or guaranteed by the Veterans' Administration were also placed in effect. The terms required by the latter agencies extend to both new and existing residences, but Regulation X applies only to any construction started on or after August 3 which is not insured or guaranteed by any department or independent agency in the executive branch of the United States Government or any Government Corporation. The credit area covered by Regulation X is commonly described as conventional mortgage lending. There is a provision for exceptions or relief from the Regulation for credit granted or commitments actually made between August 3 and October 12, the effective date of the Regulation.

The terms adopted by the organizations referred to above apply only to one- and two-family dwelling units. The terms announced by the Board of Governors of the Federal Reserve System for conventional loans and by the Administrator of the Housing and Home Finance Agency for FHA loans are identical. In addition to the down payments required, maturities are limited to 25 years for houses having a bona fide sales price of less than \$7,000 and to 20 years for any residential property in excess of that sale price. The Veterans' Administration, in compliance with the intent of Congress expressed in the Defense Production Act, adopted a set of down payment terms somewhat less stringent than that required by the other agencies. The maturity restrictions are the

same, however, except in individual cases where hardship can be proven. In those cases the maturity may be extended to 30 years. Down payments for selected purchase prices are listed below.

### MAXIMUM REAL ESTATE DOWN PAYMENTS AND MATURITIES EFFECTIVE OCTOBER 12, 1950

Value	Regulation X <sup>1</sup> and FHA		VA	
	Amount	Down payment Percentage	Amount	Down payment Percentage
\$5,000	\$ 500	10.0	\$ 250	5.0
6,000	850	14.1	250	4.2
7,000	1,200	17.1	500	7.1
8,000	1,550	19.4	750	9.4
9,000	1,900	21.1	1,000	11.1
10,000	2,300	23.0	1,300	13.0
12,000	3,100	25.8	1,900	15.8
15,000	4,300	28.7	3,550	23.7
18,000	6,700	37.2	5,800	32.2
20,000	8,300	41.5	7,300	36.5
25,000	12,500	50.0	11,250	45.0

<sup>1</sup> Covers only residential new construction or "major addition" or "major improvement" to residential property.

### Consumer credit

Effective October 14, the Board of Governors of the Federal Reserve System issued Amendment No. 1 to Regulation W. The changes in the Regulation affect down payments on all items except automobiles and home improvements, and maturities on all items except home improvements. In addition, the Regulation which formerly covered articles having a cost price of \$100 or more has been extended to those costing \$50 or more.

The new and old terms are listed below:

	Down payments (in percent)		Maturities (in months)	
	Old	New	Old	New
Automobiles	33½	33½	21	15
Television sets, radios, and other major durable goods	15	25	18	15
Furniture	10	15	18	15
Home improvements	10	10	30	30
Unclassified instalment loans	..	..	18	15

## WHAT THE FEDERAL RESERVE SYSTEM IS TRYING TO DO: REGULATION X

It is well known that the Federal Reserve System has the responsibility for formulating and implementing national monetary and credit policy, particularly as it affects the activities of our commercial banking system. The principles involved are not so generally understood, however. In the September issue of the MONTHLY REVIEW, the need for restrictions of various types to check current inflationary pressures was outlined in broad terms. Special attention was devoted to the functions performed in this regard by the general credit controls exercised by the Federal Reserve System. This article will describe briefly the principles underlying selective credit controls, using the most recent addition to that field—mortgage credit control—as the primary illustration.

As indicated in last month's article, current and contemplated increases in military output will necessitate some reduction in the volume of those types of civilian goods which use materials available in limited supply and essential to the military program. At the same time, how-

ever, the increased production of military goods and the general operation of our military establishment provide people with additional spendable income. The declining supply of civilian goods coupled with rising income creates strong inflationary pressures which need to be curbed if our economy is to operate most effectively in meeting both our military and civilian needs.

Current income, liquid assets, and borrowing constitute the three sources of spendable funds available to consumers. Since the purchase of a house represents a relatively large investment for most consumers, they rely heavily upon borrowed funds to finance such purchases. For similar reasons, credit is also used extensively to purchase automobiles, furniture, and major household appliances. As the years have gone by, more and more people have come to rely upon credit to finance purchases not only of houses, but also of automobiles and other consumer durable goods. Without such credit, home owner-

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**BUSINESS INDEXES—TWELFTH DISTRICT<sup>1</sup>**

(1935-39 average = 100)

Year and month	Industrial production (physical volume) <sup>1</sup>								Total mf'g employment <sup>4</sup>	California factory payrolls <sup>4</sup>	Car-loadings (number) <sup>2</sup>	Dep't store sales (value) <sup>2</sup>	Dep't store stocks (value) <sup>2</sup>	Retail food prices <sup>4,5</sup>
	Lumber <sup>3</sup>	Petroleum <sup>3</sup>		Cement	Lead <sup>3</sup>	Copper <sup>3</sup>	Wheat flour <sup>3</sup>	Electric power						
		Crude	Refined											
1929	148	129	127	110	171	160	106	83	....	111	135	112	134	132.0
1931	77	83	90	74	104	75	101	82	....	73	91	92	110	104.0
1932	46	78	84	48	75	33	89	73	....	54	70	69	86	89.8
1933	62	76	81	54	75	26	88	73	....	53	70	66	78	86.8
1934	67	77	81	70	79	36	95	79	....	64	81	74	83	93.2
1935	83	92	91	68	89	57	94	85	88	78	83	86	88	99.6
1936	106	94	98	117	100	98	96	96	100	96	103	99	96	100.3
1937	113	105	105	112	118	135	99	105	112	115	109	106	108	104.5
1938	88	110	103	92	96	88	96	102	96	101	96	101	101	99.0
1939	110	99	103	114	97	122	107	112	104	110	104	109	107	96.9
1940	120	98	103	124	112	144	103	122	118	134	110	119	114	97.6
1941	142	102	110	164	113	163	103	136	155	224	128	139	137	107.9
1942	141	110	116	194	118	188	104	167	230	460	137	171	190	130.9
1943	137	125	135	160	104	192	115	214	306	705	133	203	174	143.4
1944	136	137	151	128	93	171	119	231	295	694	141	223	179	142.1
1945	109	144	160	131	81	137	132	219	229	497	134	247	183	145.3
1946	130	139	148	165	73	109	128	219	175	344	136	305	238	167.4
1947	147	147	159	193	98	163	133	256	184	401	142	330	300	200.3
1948	159	149	162	211	107	153	116	284	189	430	134	353	346	216.1
1949	151	147	167	202	103	140	104	303	186	423	126	331	323	209.6
1949														
July	152	146	162	217	98	131	108	299	186	423	120	329	302	206.3
August	150	144	165	209	93	121	109	310	186	429	138	333	309	205.7
September	156	144	166	208	84	136	108	308	185	437	138	326	333	207.3
October	156	141	158	200	77	136	104	306	185	435	124	327	330	205.5
November	151	140	161	200	89	145	101	299	183	421	129	319	331	205.7
December	156	140	156	196	105	140	189	306	182	424	128	339	315	202.5
1950														
January	129	140	161	178	123	168	104	322	179	417	96	316	323	206.4
February	141	139	157	179	118	164	91	313	182	421	103	322	337	204.1
March	160	138	151	201	122	169	91	299	186	427	125	321	319	203.4
April	174	138	159	217	125	172	87	325	189	432	135	333	342	205.4
May	207	140	162	240	131	181	95	341	194	445	141	336	335	205.4
June	181	142	170	244	118	172	105	331	195	468	148	342	326	206.3
July	184	142	170	245	89r	167r	113	341	201r	...	125	454	318	209.6
August	186	145	178	251	93	176	112	340	203	...	135	373	333	210.6

**BANKING AND CREDIT STATISTICS—TWELFTH DISTRICT**

(amounts in millions of dollars)

Year and month	Condition items of all member banks <sup>1</sup>				Bank rates on short-term business loans <sup>2</sup>	Member bank reserves and related items <sup>10</sup>					Bank debits index 31 cities <sup>8,11</sup> (1935-39=100) <sup>2</sup>
	Loans and discounts	U.S. Gov't securities	Demand deposits adjusted <sup>3</sup>	Total time deposits		Reserve bank credit <sup>11</sup>	Commercial operations <sup>12</sup>	Treasury operations <sup>12</sup>	Coin and currency in circulation <sup>11</sup>	Reserves	
1929	2,239	495	1,234	1,790	.....	- 34	0	+ 23	- 6	175	146
1931	1,898	547	984	1,727	.....	+ 21	- 154	+ 154	+ 48	147	97
1932	1,570	601	840	1,618	.....	- 42	- 175	+ 234	+ 30	142	68
1933	1,486	720	951	1,609	.....	- 2	- 110	+ 150	- 18	185	63
1934	1,469	1,064	1,201	1,875	.....	- 7	- 198	+ 257	+ 4	242	72
1935	1,537	1,275	1,389	2,064	.....	+ 2	- 163	+ 219	+ 14	287	87
1936	1,682	1,334	1,791	2,101	.....	+ 6	- 227	+ 454	+ 38	479	102
1937	1,871	1,270	1,740	2,187	.....	- 1	- 90	+ 157	- 3	549	111
1938	1,869	1,323	1,781	2,221	.....	- 3	- 240	+ 276	+ 20	565	98
1939	1,967	1,450	1,983	2,267	.....	+ 2	- 192	+ 245	+ 31	584	102
1940	2,130	1,482	2,390	2,360	.....	+ 2	- 148	+ 420	+ 96	754	110
1941	2,451	1,738	2,893	2,425	.....	+ 4	- 596	+1,000	+ 227	930	134
1942	2,170	3,630	4,356	2,609	.....	+ 107	-1,980	+2,826	+ 643	1,232	165
1943	2,106	6,235	5,998	3,226	.....	+ 214	-3,751	+4,486	+ 708	1,462	211
1944	2,254	8,263	6,950	4,144	.....	+ 98	-3,534	+4,483	+ 789	1,706	237
1945	2,663	10,450	8,203	5,211	.....	- 76	-3,743	+4,682	+ 545	2,033	260
1946	4,068	8,426	8,821	5,797	.....	+ 9	-1,607	+1,329	- 326	2,094	298
1947	5,358	7,247	8,922	6,006	.....	- 302	- 443	+ 630	- 206	2,202	326
1948	6,032	6,366	8,655	6,087	.....	+ 17	+ 472	- 482	- 209	2,420	355
1949	5,925	7,016	8,536	6,255	3.20	+ 13	- 931	+ 378	- 65	1,924	350
1949											
August	5,729	6,846	8,221	6,170	.....	- 30	- 194	+ 40	+ 1	1,832	332
September	5,853	6,863	8,273	6,186	3.14	+ 13	+ 41	- 37	+ 9	1,837	336
October	5,873	6,909	8,317	6,196	.....	+ 2	- 95	+ 92	+ 7	1,831	351
November	5,919	6,944	8,511	6,157	.....	- 12	+ 21	- 2	- 16	1,854	349
December	5,925	7,016	8,536	6,255	3.16	+ 40	+ 32	+ 30	- 8	1,924	376
1950											
January	5,901	7,123	8,620	6,244	.....	- 48	- 92	+ 5	- 62	1,892	354
February	5,893	6,999	8,311	6,262	.....	+ 5	- 34	+ 7	+ 10	1,848	360
March	5,946	6,923	8,167	6,303	3.36	- 2	- 223	+ 204	- 16	1,842	373
April	5,914	6,896	8,307	6,282	.....	+ 28	- 126	+ 106	+ 4	1,821	360
May	6,005	6,932	8,354	6,275	.....	- 14	- 199	+ 170	+ 8	1,802	371
June	6,034	6,905	8,289	6,315	3.37	- 10	+ 23	+ 32	+ 5	1,836	389
July	6,162	6,310	8,458	6,250	.....	+ 3	- 149	+ 169	0	1,858	382
August	6,418	6,699	8,627	6,210	.....	- 2	- 102	+ 125	+ 18	1,863	384
September	6,664	6,495	8,754	6,213	3.29	+ 62	- 45	+ 72	+ 9	1,893	417

<sup>1</sup> All monthly indexes but wheat flour, petroleum, copper, lead, and retail food prices are adjusted for seasonal variation. Excepting for department store statistics, all indexes are based upon data from outside sources, as follows: Lumber, various lumber trade associations; Petroleum, Cement, Copper, and Lead, U.S. Bureau of Mines; Wheat flour, U.S. Bureau of the Census; Electric power, Federal Power Commission; Manufacturing employment, U.S. Bureau of Labor Statistics and cooperating state agencies; Factory payrolls, California State Division of Labor Statistics and Research; Retail food prices, U.S. Bureau of Labor Statistics; and Carloadings, various railroads and railroad associations. <sup>2</sup> Daily average. <sup>3</sup> Not adjusted for seasonal variation. <sup>4</sup> Excludes fish, fruit, and vegetable canning. Factory payrolls index covers wage earners only. <sup>5</sup> At retail, end of month or year. <sup>6</sup> Los Angeles, San Francisco, and Seattle indexes combined. <sup>7</sup> Annual figures are as of end of year; monthly figures as of last Wednesday in month or, where applicable, as of call report date. <sup>8</sup> Demand deposits, excluding interbank and U.S. Gov't deposits, less cash items in process of collection. Monthly data partly estimated. <sup>9</sup> New quarterly series beginning June 1948. Average rates on loans made in five major cities during the first 15 days of the month. <sup>10</sup> End of year and end of month figures. <sup>11</sup> Changes from end of previous month or year. <sup>12</sup> Minus sign indicates flow of funds out of the District in the case of commercial operations, and excess of receipts over disbursements in the case of Treasury operations. <sup>13</sup> Debits to total deposit accounts, excluding interbank deposits. <sup>14</sup> Revised series from 1945 to date. Explanation of revision will appear in the November issue. p—preliminary. r—revised.



## WHAT THE FEDERAL RESERVE SYSTEM IS TRYING TO DO: REGULATION X

(Continued from page 132)

ship and mass distribution of durable goods would have been less widespread.

In times such as the present, however, when current income is likely to outrun the supply of goods and services unless prices are allowed to rise drastically, the unrestrained use of mortgage and consumer credit serves to accentuate the imbalance between demand and supply. This leads to additional upward pressure upon prices and speeds our course of ascent on the dangerous inflationary spiral.

The recent actions to tighten residential mortgage credit, including Regulation X of the Board of Governors of the Federal Reserve System and the associated restrictions on FHA and VA loans announced by the Housing and Home Finance Administrator,<sup>1</sup> were taken for the purpose of lessening the current demand for housing by checking the growth in mortgage credit. There is a two-fold need for this reduction in demand. In the first place, because housing construction has been running at unprecedented levels so far this year, the prices of lumber, plywood, cement, brick, tile, and many other materials had risen to very high levels. Without some restriction upon demand for the finished product—a house, the prices of these materials in all probability would have been forced to still higher levels. Moreover, it had become increasingly evident that the current volume of building could not be maintained, and in fact it had already shown signs of decline, owing to the scarcity of certain critical materials and equipment needed in the final stages of construction. Secondly, our stepped-up defense program requires that in the near future a significant proportion of these materials must be diverted from housing to defense. The most efficient way to accomplish this is to reduce the demand for housing by tightening up on mortgage credit.

This method makes it possible for the flow of materials to the housing market to diminish and the flow to the defense market to increase with little, if any, upward pressure upon prices. In the absence of credit restriction or direct allocation or rationing, the diversion of materials could be accomplished only by competitive bidding between the housing and defense markets. This could serve only to drive prices higher and higher until enough people were priced out of the housing market to enable the Government to get the materials it needs. This obviously would increase costs both to home purchasers and to the Government—and ultimately to the taxpayers who have to foot the Government's bills.

In the light of the defense program as currently indicated, it has been estimated that the materials and labor available for residential construction will not allow the building of more than 800,000 to 850,000 new housing

units in 1951. The recent action in tightening credit terms seeks to hold the demand for housing to about that level. The creation of credit supporting a demand for more houses than that would not increase the number of houses built. All that it would do would be to contribute to further inflation and higher prices—a fact that needs to be kept constantly in mind.

This goal involves, admittedly, a significant reduction from the unprecedentedly high level of construction activity achieved this year. It is estimated that 1,400,000 houses will have been started during the entire year 1950. However, the construction of 800,000 housing units in 1951 would still be a relatively high level of activity, exceeded only in the postwar years beginning with 1947 and in four years during the housing boom of the mid-twenties. Furthermore, if it should develop that the requirements of the defense program or the effects of these credit restrictions upon the demand for housing were not anticipated correctly, these regulations may readily be loosened—or tightened—as circumstances require.

On the surface it may appear that these restrictions, including both those on consumer and mortgage credit, benefit the wealthy as against those with lower incomes. However, such a view assumes, whether recognized or not, that there really need be no reduction in the supply of new houses or of other consumer durable goods, and that demands can be satisfied without further price increases. But if increased military needs are to be met, someone must give up something that he might otherwise have had. The alternative to credit restrictions is either price controls and rationing, or it is to reduce buying through still higher prices. The first of these alternatives involves great inconvenience to everyone and necessitates setting up elaborate governmental machinery. Under the second alternative, the people who would first be priced out of the market would be those with lower incomes and smaller savings. Short of a system of rationing on the basis of need (as determined by a Government agency) without regard for an individual's financial condition, the man who has saved his money to buy something is inevitably in a preferred position compared to the man who lacks the necessary funds.

Controls over consumer and mortgage credit will not do the job by themselves. Increased production is obviously essential. But since it requires time and materials to increase productive capacity, this does not offer a major solution to our immediate problem. For the present, higher taxes and reduced Federal expenditures wherever possible are the major weapons in our fight against inflation. If we are to succeed in that fight, we—consumers, business, and government—must accept less in terms of civilian goods and services than we are trying to get with the incomes, liquid assets, and access to credit that we have.

<sup>1</sup> For a description of the terms of these various restrictions, see page 132.