

May 1962

# FEDERAL RESERVE BANK OF ST. LOUIS

# *Review*



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FEDERAL RESERVE BANK  
OF ST. LOUIS

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# Recent Financial Developments

**R**ECENT MONETARY AND FINANCIAL DEVELOPMENTS present a mixed picture. Bank reserves, bank credit, and the money supply rose markedly from early March to early April. Since the end of 1961 member bank reserves and the money supply have changed little on balance. On the other hand, total bank credit and time deposits in commercial banks have expanded sharply. The general level of interest rates has declined.

## *Money Supply*

The nation's money supply, demand deposits adjusted plus currency in circulation, increased sharply from late February to early April but was about unchanged during the first three-and-one-half months of 1962 after adjustment for seasonal variation. This relative stability in the quantity of money followed a rapid increase from last August to the end of the year. The recent stability in the money supply also contrasts with the expansion of the money supply during the comparable phase of the two previous business expansions.

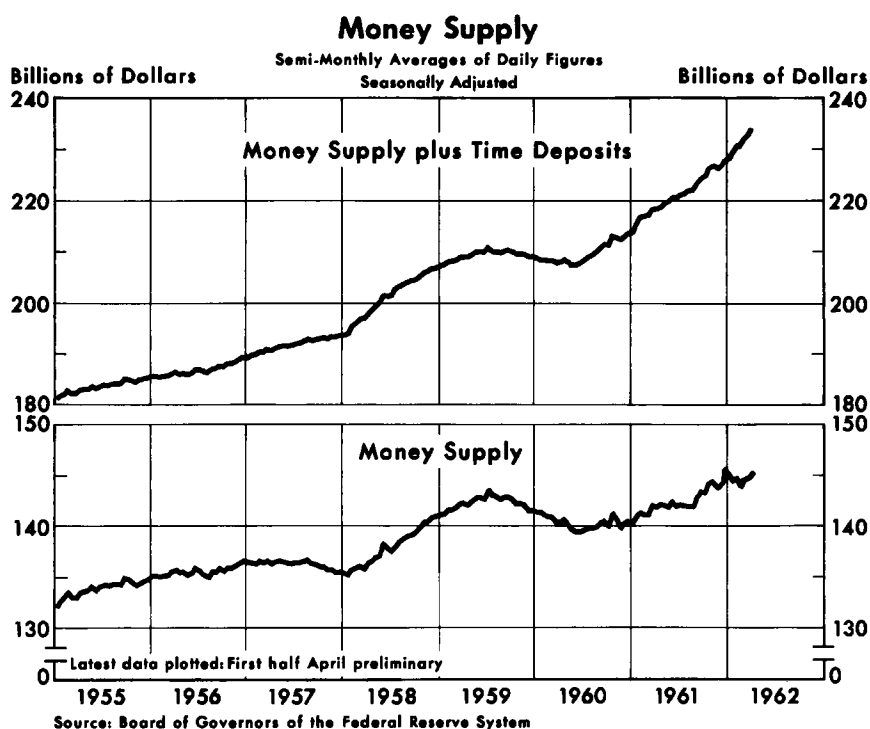
While the money supply was unchanged in early 1962, total spending rose. The turnover of demand deposits has continued to increase in recent months. The annual rate of turnover at reporting centers outside the seven largest financial centers reached a low of 25.7 times per year (three-month moving average) in January 1961, rose to 27.1 times per year in December of last year, and is estimated to be 27.4 times per year in March 1962. Income velocity, i.e., gross national product divided by the money supply, also reached a low during the first quarter of 1961 and has since been rising steadily.

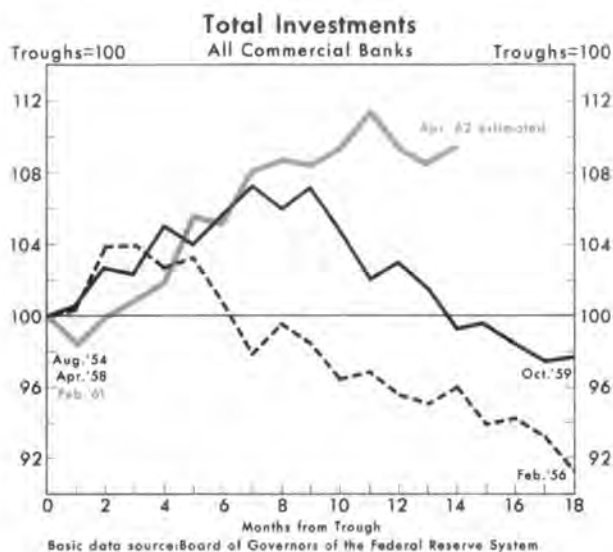
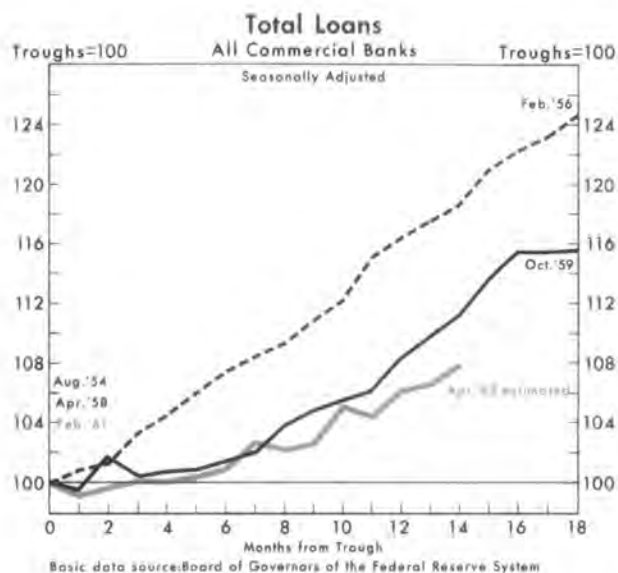
Time deposits at commercial banks, seasonally adjusted, expanded markedly at an annual rate of 27 per cent from the last half of December to the first half of April. This compares with a rate of about 14 per cent from mid-1960 to the end of 1961.

The rapid increase in time deposits in the early months of 1962 resulted in part from the higher rates being paid by the many banks on these deposits. However, the rate of increase appears to be slowing. Time deposits expanded at an annual rate of about 40 per cent in January of this year but expanded at an annual rate of 18 per cent in March and the first half of April. As a result of the rapid expansion in time deposits, money supply plus time deposits has continued to increase at a rapid pace thus far in 1962.

## *Bank Credit*

Total loans and investments of commercial banks, seasonally adjusted, which have been expanding since mid-1961, increased at an annual rate of 7.9 per cent during the first quarter of this year. Total bank credit was about unchanged in January, expanded sharply in February, and increased moderately during March. Preliminary estimates indicate that bank credit expanded further in April. The first-quarter increase in bank credit reflected an expansion in loans, with most





categories of loans showing an increase. Investments rose in January but decreased slightly during February and March. In recent months banks have reduced their U. S. Government securities but have increased holdings of state and local obligations.

The expansion in loans has been characteristic of the expansion phase of postwar business cycles. During the early months of recovery, when loan demand has generally been weak, banks have utilized gains in reserves to buy investments, primarily short-term Government securities. As the pace of business improves and loan demand picks up, banks tend to increase their loans (which generally carry a higher yield) and to reduce their holdings of securities.

Despite the recent increase, commercial bank loans have expanded less in the current recovery than in the two preceding recoveries. From the February

1961 trough to March 1962, loans expanded at an annual rate of 6 per cent. In the thirteen months following the April 1958 and August 1954 troughs, loans expanded at rates of 9 per cent and 16 per cent. Investments have increased at an annual rate of 8 per cent since the most recent trough. By comparison, investments were only slightly higher thirteen months following the April 1958 trough and had declined at an annual rate of 5 per cent during the comparable period following the August 1954 trough.

## Bank Reserves, Money Supply and Bank Credit\*

### ANNUAL RATES OF CHANGE

#### Periods Between Marked and Sustained Change

Total Reserves	Annual Rates
2nd half Dec. 1959 — 1st half June 1960.....	— 0.8
1st half June 1960 — 2nd half Feb. 1961.....	+ 8.0
2nd half Feb. 1961 — 2nd half July 1961.....	— 4.7
2nd half July 1961 — 2nd half Nov. 1961.....	+ 13.5
2nd half Nov. 1961 — 1st half Apr. 1962.....	— 0.4

Monetary Reserves	
2nd half Dec. 1959 — 1st half June 1960.....	— 2.5
1st half June 1960 — 2nd half Feb. 1961.....	+ 8.6
2nd half Feb. 1961 — 1st half Aug. 1961.....	— 0.3
1st half Aug. 1961 — 1st half Jan. 1962.....	+ 8.7
1st half Jan. 1962 — 1st half Apr. 1962.....	— 1.4

Money Supply	
2nd half Dec. 1959 — 2nd half June 1960.....	— 3.0
2nd half June 1960 — 2nd half Mar. 1961.....	+ 2.5
2nd half Mar. 1961 — 2nd half Aug. 1961.....	— 0.3
2nd half Aug. 1961 — 2nd half Dec. 1961.....	+ 7.8
2nd half Dec. 1961 — 1st half Apr. 1962.....	— 0.5

Time Deposits	
2nd half Dec. 1959 — 1st half June 1960.....	+ 1.1
1st half June 1960 — 2nd half Dec. 1961.....	+ 13.8
2nd half Dec. 1961 — 1st half Apr. 1962.....	+ 26.6

Money Supply Plus Time Deposits	
2nd half Dec. 1959 — 1st half June 1960.....	— 1.8
1st half June 1960 — 2nd half Mar. 1961.....	+ 6.6
2nd half Mar. 1961 — 2nd half Aug. 1961.....	+ 4.2
2nd half Aug. 1961 — 1st half Apr. 1962.....	+ 8.8

Bank Credit	
2nd half Dec. 1959 — 2nd half Apr. 1960.....	+ 2.3
2nd half Apr. 1960 — 2nd half Feb. 1961.....	+ 6.6
2nd half Feb. 1961 — 1st half July 1961.....	+ 2.1
1st half July 1961 — 1st half Apr. 1962.....	+ 9.6

\*Daily average figures (except bank credit which is twice a month) seasonally adjusted. First half April preliminary.

## Bank Reserves

Total member bank reserves, seasonally adjusted, increased from early March to early April but were about unchanged on balance from late 1961 to early April. This relative stability contrasts with a sharp rise in reserves during most of 1961. Monetary reserves (i.e. reserves available to support the privately held money supply) moved similarly to total reserves. From early March to early April they rose substantially, but from January to early April they were virtually unchanged.

Excess reserves averaged about \$500 million in February, March, and April, down \$100 million from the average of the previous twelve months. Member bank borrowing from Reserve Banks continued to average below \$100 million during recent months. Free reserves, the difference between excess reserves



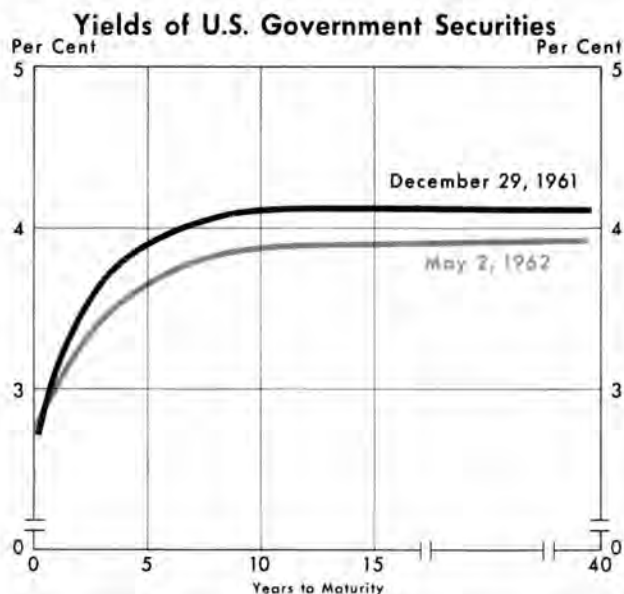
and borrowings, a commonly used measure of money market ease or restraint, were lower during the February to April period than in most other recent months.

Despite the relative stability of total reserves, bank credit and total deposits of the banking system have expanded markedly in recent months. The expansion of total bank credit and the money supply plus time deposits occurring during a period when total and monetary reserves were about unchanged reflects two developments: 1) Banks utilized their reserves more intensively as shown by the decline in excess reserves. 2) The decline in demand deposits and the increase

in time deposits (which have a lower reserve requirement) made the same amount of reserves adequate for a bank credit expansion.

## Interest Rates

Interest rates on three-month Treasury bills averaged 2.74 per cent in April, about the same as in the first three months of this year, but somewhat above the level of December 1961. Yields on intermediate and long-term U. S. Government obligations and municipal securities declined in the first four months of 1962.



The decline in interest rates on most marketable securities resulted from changes in both the supply and demand for funds. The total supply of lendable funds probably has increased at a more rapid rate in recent months than in late 1961. Preliminary indications suggest a rise in the rate of liquid saving during the first quarter of 1962, perhaps resulting from expanding personal incomes and higher rates available on savings accounts. As mentioned above, bank credit has also expanded rapidly in this period. On the demand side, the mild pace of the business expansion indicates that there has been only a modest over-all increase in the demand for funds.

The shift in the yield curve in recent months partially reflects actions of the commercial banks. With the expansion in time deposits and the accompanying increase in bank costs, bankers have sought to obtain higher yields on their investments. Consequently, in an effort to increase earnings, many banks have attempted to extend the average maturity of their portfolio. As a result, the supply of funds in the in-

intermediate- and long-term sector has increased, producing higher prices (lower yields) on Government and municipal securities in these maturity ranges. On the other hand, commercial bank sales of Treasury bills and debt management activities of the Treasury which increased the quantity of short-term government securities have put upward pressure on short-term rates. In addition, some investors may have shifted their funds from short-term marketable securities to time deposits.

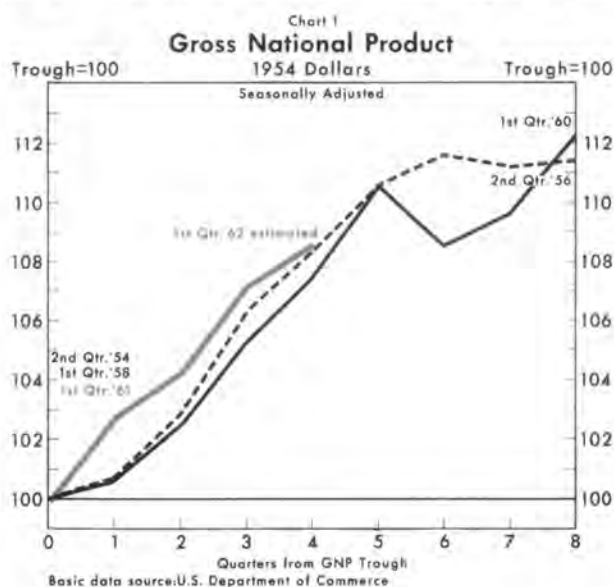
## Bank Liquidity

The liquidity of the commercial banking system has apparently declined in recent months according to several measures. The ratio of loans to deposits increased from 52.2 per cent in December last year to 54.2 per cent in March. As mentioned above, excess reserves have been at a low level during most of this year compared with the level which prevailed in 1961. The amount of Treasury bills held by commercial banks declined during the first four months of this year.

# Business Improves Moderately

## Expenditures Rise

**B**USINESS ACTIVITY in the first quarter of this year was only moderately higher than in the preceding quarter. Expenditures on currently produced goods and services, gross national product, increased \$6.8 billion from fourth-quarter 1961 to first-quarter 1962. This increase was considerably less than the \$16.4 billion rise from third- to fourth-quarter 1961.



There was a decline in consumer spending on durable goods and a sharp drop in expenditures on residential construction from fourth-quarter 1961 to the first quarter of this year. These declines, coupled with decreases in the rate of increase in Federal expenditures and in producer expenditures on equipment, largely accounted for the slowdown in the expansion of GNP.

It is not unusual, however, for the pace of economic activity to moderate as the economy moves beyond the recovery phase of a business cycle (see Chart 1). Therefore, in judging the strength of the current expansion it may be meaningful to relate it to performance during corresponding periods in 1958-59 and 1954-55. Gross national product reached its recession low during the first quarter of 1961. Since that time, total expenditures, after adjusting for price changes, have risen an estimated 8.6 per cent. This rate of expansion compares with increases of 7.4 and 8.3 per cent during comparable periods in 1958-59 and 1954-55, respectively.<sup>1</sup>

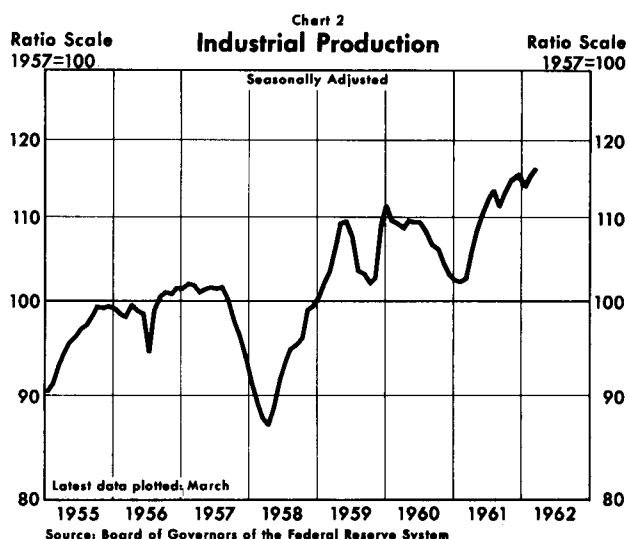
There are indications of an expansion in spending during April. Expenditures on residential construction rose from March to April, reversing a four-month decline. Automobile sales in April reached a seasonally adjusted annual rate of nearly 7 million units, up substantially from the advanced pace in March. Department store sales in April remained near the high March level.

## Output Expands

Output of the nation's mines, factories, and utilities rose from January through March of this year, reaching a level about 13 per cent above the recession low. Fragmentary data point to a moderate increase in April. Automobile production was at a more rapid pace than in any April since 1955. On the other hand, steel output declined sharply during the month.

<sup>1</sup> The 1958-59 period is from first quarter 1958, the recession low in GNP, to first quarter 1959. The 1954-55 period is from second quarter 1954, the recession low in GNP, to second quarter 1955.



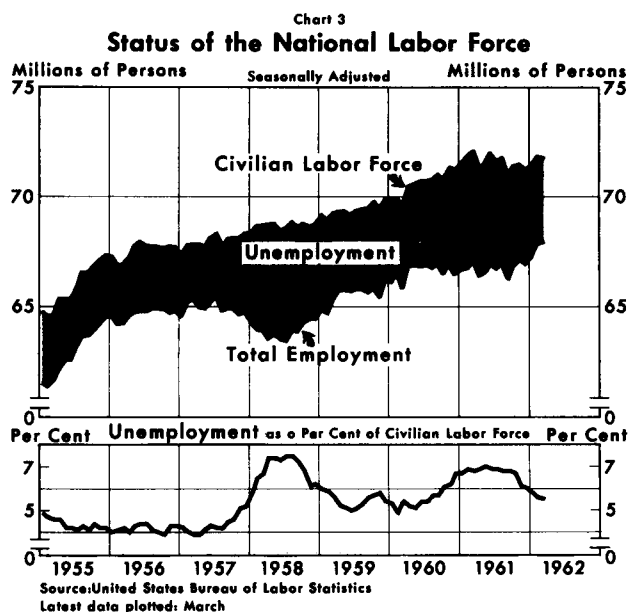


The increase in output from January to March followed a mild dip from December 1961 to January. In contrast to this recent upswing, however, a somewhat broader view reveals a more general slowdown in the pace of advance (see Chart 2). From August 1961 (the sixth month of recovery) to March 1962 (the thirteenth month) output rose only about 3 per cent. This compares with increases of 14 and 8 per cent during the corresponding periods of the 1958-59 and 1954-55 recoveries.

The comparative lack of vigor over the past eight months may be largely due to such special circumstances as the 1961 automobile strike, which adversely affected production during September and October 1961, and unusually bad weather during January.

## Employment Rises

Employment rose sharply in the first quarter of this year, increasing 1.5 per cent from December 1961 to March. Taking a somewhat broader view, however, the recent three-month rise appears less reassuring (see Chart 3). Total civilian employment in March was only 1.4 per cent above the August 1961 level and 1.8 per cent above the level prevailing in February of last year, the trough month of the 1960-61 recession. Moreover, the rise in employment since February 1961 barely matched the decline in unemployment. Thus, after more than a year of economic recovery and expansion, the civilian labor force was about the same size as it was at the trough of the preceding contraction.<sup>2</sup> The civilian labor force expanded during each of the previous postwar recoveries.



Reflecting these changes, the proportion of unemployed in the civilian labor force declined moderately through the initial quarter of this year, from a seasonally adjusted 6.0 per cent in December 1961 to 5.5 per cent in March 1962.

## Price Level Steady

Average prices changed little in early 1962. The consumer price index rose from 104.5 in December (1957-59=100) to 105.0 in March, largely reflecting an increase in food prices. During the same period, the wholesale price index showed little net change.

## District Developments

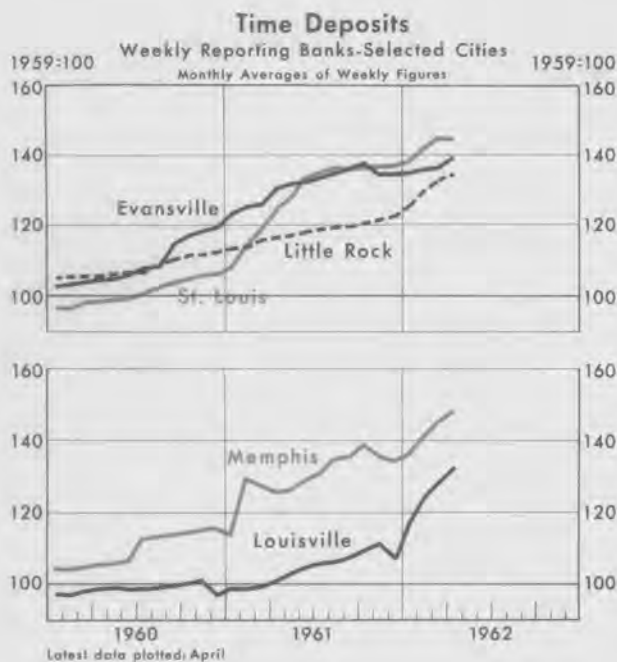
**B**USINESS ACTIVITY in the Eighth Federal Reserve District improved slightly during the first quarter of 1962. Electric power consumption of manufacturing firms in the metropolitan areas of the District rose more than seasonally from December to March. Employment at the major centers rose moderately during the period, and unemployment declined (see charts, Page 7). Sales of reporting department stores declined from December 1961 to

<sup>2</sup> The seasonally adjusted civilian labor force actually declined slightly from February 1961 to March 1962. Because the totals and the components in the labor force data are seasonally adjusted separately, the seasonally adjusted components do not add.

February, but rose sharply in March. According to preliminary data, these sales continued to expand in early April, reaching levels somewhat higher than at the end of last year. Cash farm income in the district during the first quarter was above the year ago level; higher prices for cattle, broilers, and most crops accounted for the rise.

Banking developments in the district followed the national pattern. Total deposits of member banks in the Eighth District averaged somewhat higher in April than during late 1961, after adjustment for seasonal variation. Demand deposits drifted downward during the first four months of 1962. In contrast, time deposits showed a rapid increase during the first four months of this year and were about 9 per cent higher in April than in December. The increase was sharpest at banks in Louisville, where time deposits increased 24 per cent in the first four months of this year.

Total loans and investments at district member banks rose moderately in March and April and were about 2 per cent higher than in December. A rise in loans more than offset a decline in investments. The major portion of the gain in loan volume was in consumer and real estate loans. The rise in the loan-to-deposit ratio in the early month of this year at district banks was more pronounced than at banks throughout the nation.



# The International Payments System

**T**HE CONTINUING PAYMENTS IMBALANCES among the leading countries are a major economic problem. They are a source of concern to those interested in the growth of trade, currency convertibility, and exchange rate stability. Massive movements of short-term capital which began in the second half of 1960 and continued on in sporadic outbursts through 1961 have contributed to a conviction that the international payments mechanism must be strengthened.

The purpose of this article is to examine some of the "mechanics" of the current international payments system. It attempts to answer the question: How does the payments system respond to basic imbalances and the shifts of short-term capital? Such an examination may provide a basis for understanding some of the steps in international cooperation initially developed in 1961.

## International Payments: A Transfer of Bank Balances

The distinctive feature of international payments is the necessity for converting one currency into another. When exporters acquire claims on foreign currencies they generally convert them into their own money. When the task of financing falls on the importer, he must convert his local currency into a foreign balance satisfactory to the foreign seller.

Converting currency A into currency B or currency B into currency A is essentially a banking function. In every major country of the world there is a cluster of banks specializing in the buying and selling of foreign balances. In most countries of the world official institutions, such as central banks and government stabilization funds, also buy and sell foreign balances.

Commercial banks and other institutions acquire foreign bank balances by buying exporters' claims on foreign money or by borrowing such balances. Banks may also acquire foreign balances by selling dollars in the foreign exchange market. In New York City, for instance, about 25 banks purchase claims on foreign balances from exporters or others and thus acquire deposit accounts in banks distributed through-

out the various foreign money markets. On the basis of balances held abroad, banks may sell claims on foreign money to importers or others who are required to pay in foreign money. The importer in effect buys with dollars from a U. S. bank a foreign bank account.

This trading in foreign balances goes on in all the leading money markets of the world. Balances of marks, pounds, francs, and other currencies are bought and sold in the New York market. Dollar balances and a host of other currencies are bought and sold in the foreign markets. The network of foreign balances maintained by banks throughout the world makes it possible to have a particular transaction settled in more than one currency. Payments made by Americans to Germans, for instance, may be settled in marks or dollars. If the terms of the contract require payment in *marks*, the settlement of the transaction by the American importer will lead to a reduction in mark balances maintained by an American bank. If the transaction is denominated in *dollars*, the settlement of this transaction leads to an increase in dollar balances owned by a German bank. In this case the German exporter generally sells his claims on dollars to his local bank in exchange for marks. The German bank thus acquires a dollar balance in the United States which it may hold. Or it may sell the balance to its own central bank or to some private institution.

## Foreign Exchange Rates

### *The Price of Foreign Currency: The Rate of Exchange*

The trading in bank balances in the various foreign exchange markets takes place at prices which indicate the amount of one currency required to buy another. In New York the prices of foreign money (exchange rates) are quoted in terms of American money *expressed in United States cents*. On a given day in March of this year one could have found in New York quotes of 281.78 for sterling, 23.033 for Swiss francs, 25.005 for German marks, and 20.41 for French francs. In foreign exchange markets abroad comparable exchange rates are quoted. In the London market the pound-dollar exchange is stated as so much English currency per dollar; in Germany, it is the number of marks for one dollar, pound, et cetera.



For most currencies, there is an officially declared parity, expressed in terms of a specified quantity of gold or dollars. The determination of par values is part of the international monetary system established in the Bretton Woods Agreement of 1944.

According to this agreement, which established the International Monetary Fund, the par value of the currency of each member is expressed in terms of gold as a common denominator or in terms of United States dollars of the weight and fineness in effect on July 1, 1944. The relationship between gold and the currencies of member nations is indirect in the sense that the franc, the mark, the pound, and other currencies are convertible into gold only via the exchange of dollar balances for gold between foreign official institutions and the United States Treasury. Thus the cornerstone of the world's exchange rate structure is the willingness of the United States Treasury to buy and sell gold at the fixed price of \$35 per ounce.

### *The Rate of Exchange and Demand and Supply*

Actual exchange rates fluctuate above and below the official par values, within margins prescribed by international agreement, in response to the influence of demand and supply. The nature of demand and supply in this case requires some explanation.

In the United States foreign exchange market, we speak of a demand for foreign currency as arising from the total United States imports of goods, services, and securities. The supply of foreign exchange in the United States depends on exports by Americans of goods, services, and securities.

In the case of United States payments to foreign countries, how does the demand for foreign currencies manifest itself? Dollars are *offered* by American importers for the purchase of foreign balances of American banks. The demand for foreign currency is also expressed in other foreign exchange markets by foreign exporters with claims on dollars. The exporters desire local currency to pay their domestic bills. To acquire marks or pounds they offer their dollar claims to local banks in exchange for their national currency. In this sense the demand for foreign currency is expressed by an offering of dollars in both the New York and the foreign markets. The increased demand for foreign currency by *American importers* and *foreign exporters* tends to raise the dollar price of foreign currency. In New York we might observe the price of marks move up to 25.1 cents from 25.0; the pound sterling move up to 282 cents from 281 cents, et cetera.

In the opposite situation, in which substantial foreign payments are made to the United States, larger amounts of foreign currency will be offered for dollars. This larger *supply* of foreign balances is a larger *demand* for dollars. If it is the foreign importer who takes the initiative he will go to his bank and *buy* dollar balances with his local currency. If it is the American exporter who takes the initiative, he will *offer* his claims on foreign currency to an American foreign exchange bank in exchange for dollars. The foreign exchange markets respond to this demand for dollars by the foreign importer and the American exporter by reducing the value of foreign currency relative to the dollar. In the United States market this would be expressed by a *reduction* in the United States price of foreign currency. The pound sterling might drop from 281 cents to 279 cents; the mark from 25.2 to 25.0 cents. In this sense one could say that there was a weakening of the pound and mark vis-a-vis the dollar.

With transactions in different foreign markets going on at the same time, one might expect the value of the mark relative to the dollar in Frankfurt to differ from the exchange rate in the New York market. The mark might be worth 25.0 cents in Frankfurt and 24.9 cents in New York. A differential, while possible for a short time, tends to disappear in the process of exchange *arbitrage*. The speed of communication by cable makes it possible for dealers working through correspondent banks to offer mark balances for dollars in Frankfurt where marks are relatively "dear" while at the same time buying up mark balances with dollars in the New York market where marks are relatively "cheap". The buying of marks in the New York market (a price-raising force) and the selling of marks in Frankfurt (a price-reducing force) would tend to destroy the exchange rate differential. Thus, it is possible to speak of the dollar price of marks, (or other currencies) at any given time, as a world price—the same price being quoted in all foreign exchange markets.

### *The Limited Range of Exchange Rate Fluctuations*

An integral part of the exchange rate agreements among the member nations of the IMF is that exchange rate fluctuations around the "established par" are permitted, but only to the extent that they do not rise above or fall below the established par by more than a certain per cent.<sup>1</sup> The responsibility for keeping a currency's value tied to the dollar within this range is that of the central bank or government

<sup>1</sup> Most central banks use  $\frac{3}{4}$  of one per cent.

stabilization fund. Until 1961 the United States role in the foreign exchange markets was completely passive except that the United States Treasury maintained the fixed relationship between gold and dollars. The official institutions of other IMF member nations intervened in the markets to establish exchange rate ceilings and floors for their currencies in terms of dollars.

In the event of a heavy payments outflow from the United States to West Germany, for instance, the value of the mark tends to rise relative to the dollar. Once the price of marks rises to a level  $\frac{3}{4}$  of one per cent above the established par of 25 cents (25.1875), the German Bundesbank is required to enter the market to buy dollars with marks. This central bank selling of marks (buying of dollars) prevents the mark from rising any further relative to the dollar.

In the opposite situation of heavy German payment outflows to the United States, the value of the mark relative to the dollar would tend to fall. If it fell to the "lower intervention point",  $\frac{3}{4}$  of 1 per cent below par, the Bundesbank would support the mark by heavy sales of dollars in the purchase of marks.

### Official Reserves of Central Banks

Central bank intervention in the foreign exchange markets to limit exchange rate fluctuations is but one aspect of the important role of these official institutions in the operation of the international payments mechanism. To meet adverse payments situations, foreign central banks also hold reserves of gold and some widely accepted currencies, most notably the dollar and the pound. How these "official" reserves are managed has an important bearing on the functioning of the payments mechanism.

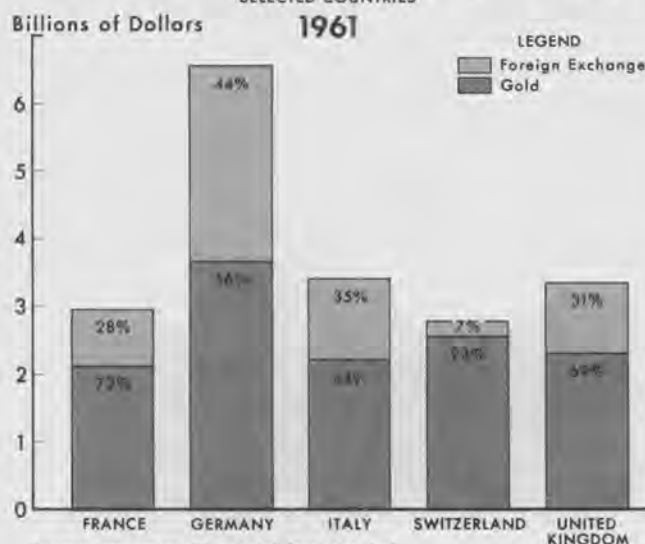
Nations have learned that an excess of payments over receipts can quickly exhaust the foreign exchange balances maintained by private commercial banks. Since the countries experiencing the payments deficit cannot count on the willingness of the commercial banks of the payments surplus countries to accumulate bank balances in the deficit country, supplementary reserves of an acceptable means of payment must be held by central banks.

#### Gold Reserves

Gold has for many centuries served as the major means of settling payments imbalances. There is no question as to its acceptability. At the end of 1961 gold was approximately 70 per cent of Britain's official foreign reserves; 93 per cent of Switzerland's; 72

per cent of France's; 56 per cent of Germany's; and 65 per cent of Italy's. The official reserves of the United States consist almost entirely of gold.

### Official Reserves of Gold & Foreign Exchange SELECTED COUNTRIES



An important feature of central bank reserves is that monetary authorities apparently strive to maintain a certain proportion of their official reserves in the form of gold. The proportion adhered to varies from country to country, but a review of gold holdings for the period 1951 through 1961 reveals that some countries such as the United Kingdom, France, and Switzerland normally keep a large proportion of their total reserves in the form of gold. Germany and Italy choose to hold more moderate proportions.

The significance of this policy with respect to gold proportions is that when foreign currency holdings become excessive relative to gold holdings, central banks convert a portion of their foreign exchange reserves into gold. This has an important bearing on the reserve position of the country whose currency is used as the foreign exchange component of central bank reserves.

#### Foreign Exchange Reserves

In the 19th century the pound sterling was the important reserve currency because of its wide acceptability. This reflected the fact that London was the important trade center of the world with an exceptionally well-developed money market. Although sterling is still a component of central bank reserves, particularly among the Commonwealth countries, the dollar has become the reserve currency for most other countries.

The dollar's role as an international medium of exchange and a reserve currency is based on a number of different factors. Since 1934 the value of the dollar has been fixed in terms of gold at \$35 per ounce. With the United States Treasury willing to sell gold to foreign official institutions at this fixed price, for legitimate monetary purposes, the dollar has been considered "as good as gold".

Contributing to the wide acceptance of the dollar as a medium of exchange has been its record of convertibility. Unlike currencies whose convertibility into other currencies was tightly regulated from the thirties through the mid-fifties, the dollar has been freely convertible during the entire postwar period. On the other hand, a holder of marks, pounds, or francs, in the early postwar period, was usually subject to restrictions limiting the use of the balance to particular transactions and to particular currencies.

The Bretton Woods Agreement of 1944, under which the International Monetary Fund was established, enhanced the status of the dollar by requiring that member countries determine the basic rates (par values) at which their currencies exchange for dollars and gold equivalents. The dollar, tied to gold by United States Treasury policy, was officially recognized by a world institution as the basis for the world's exchange rate structure.

Other factors contributing to dollars as an important reserve currency are the importance of the New York market as a trade center and as a capital market with a host of opportunities for the investment of liquid balances. As a result, it has become convenient for foreign commercial banks to hold large operating balances in United States dollars and a matter of policy for foreign monetary authorities to hold reserve balances in a currency considered "good as gold". At the end of 1961, private dollar holdings amounted to \$7.7 billion. Official dollar reserves totaled \$10.9 billion.

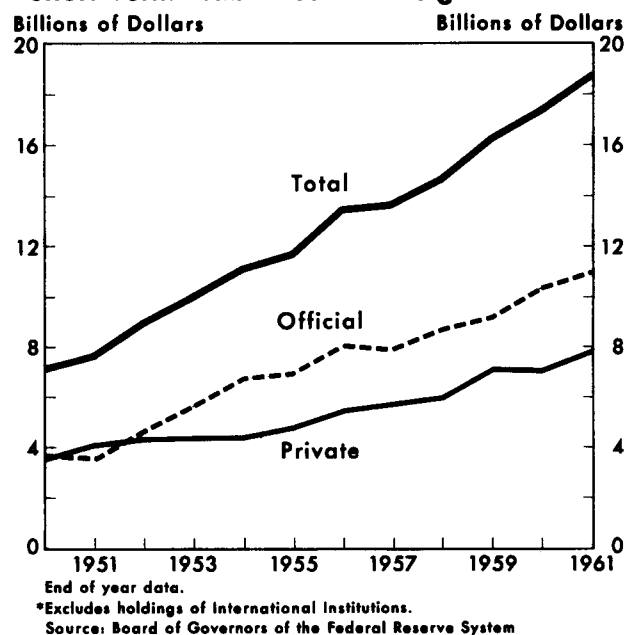
We shall have occasion to observe that changes in the total of foreign held dollars (private and official), and the shifting of balances between private and official foreign ownership have important impacts on United States gold reserves.

### World Trading in Dollars

With the dollar an important medium of exchange and the most important currency component of central bank reserves, international transactions are re-

flected primarily in ownership transfers of dollar bank accounts. If the United States incurs a deficit in her balance of payments, the payments excess customarily leads to an increase of dollar balances held by foreigners rather than a decrease of American holdings of foreign currencies. Conversely, if the United States develops a surplus payments position, a position typical of the period prior to 1950, the excess receipts are reflected primarily in a reduction of dollar balances held by foreigners, instead of an increase in American holdings of foreign bank balances. Since the United States has incurred balance-of-payments deficits for the last twelve years (excepting 1957), foreign ownership of dollars has increased substantially.

### Short-Term Liabilities to Foreign Countries\*



In addition to the increases and decreases of total foreign ownership of dollar balances, there is considerable shifting of dollar balances among the foreign nations. These shifts reflect the dollar's importance as an international medium of exchange and the fact that foreign holders have accumulated substantial dollar balances in recent years.

The "pool" of dollars now held by foreigners is used to finance trade transactions and short-term capital movements that need not directly involve the United States. The French may use their dollar holdings to buy English goods. This leads to a transfer of dollar balances from French to British ownership. Foreign holders of dollars participate in short-term capital movements. They may be attracted by relatively high interest returns in a particular money

market. They may wish to move short-term funds into a "strong" currency in response to speculative anticipations of a possible increase in the par value of that currency. Whatever the cause, massive short-term capital movements have occurred in recent years. They have produced substantial shifts in the ownership of dollar balances among foreign private and official holders.

In early 1961, a large capital outflow from London to the Continental countries followed the revaluation of German and Dutch currencies. The outflow of capital was effected through sales of pounds for dollars which were in turn sold for Continental currencies. As private dollar balances were exchanged for Continental currencies, ownership of dollars shifted from London to the Continent.

This transfer of dollars to the Continent from London produced important impacts on the official dollar holdings of various central banks. In London the British authorities sold dollar reserves in order to support the sterling exchange rate. On the Continent, a number of central banks had to purchase increasing amounts of dollars in order to keep their currencies from appreciating beyond the limits set by international agreement.

An important feature of the extensive use of dollars by foreign nations is the market for short-term dollar deposits, known as the Euro-dollar market. Centered in London, the market brings together banks and businesses holding temporary excess dollar balances (lenders) with other banks and businesses (borrowers) seeking dollars for trade financing or for short-term investment in local money markets. Persons in the market believe the total volume of outstanding obligations in this market ranges from \$1 to \$2 billion.

A network of London banks acting primarily as intermediaries is a significant part of this market. These banks accept short-term dollar deposits from banks and businesses and pay interest on these deposits. These intermediaries then offer these dollar deposits at a slightly higher rate of interest to those wishing to use dollars for trade financing and investment.<sup>2</sup>

The Euro-dollar market, by providing facilities for the utilization of dollar balances that otherwise might have been idle, has broadened the use of dollars as an international medium of exchange.

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<sup>2</sup> For a more complete description of this market, see Federal Reserve Bank of New York, *Monthly Review* November 1960, pp. 197-202.

## **United States Gold Reserves and Central Bank Reserves**

The willingness of foreigners to use and hold dollar balances does not free the United States from the possibility of changes in gold reserves. The United States maintains a policy of selling gold to central banks and governments for legitimate monetary purposes. Central banks hold dollars as part of their official reserves but they generally insist on keeping a relatively fixed proportion of their reserves in the form of gold. In the course of maintaining these gold proportions, central banks acquiring substantial additions to their dollar holdings are likely to convert their excess dollars into gold. In the four-year period, 1958-1961, United States gold stocks declined almost \$6 billion.

It is apparent that the volume of dollar balances acquired by foreign central banks is influenced by three forces: (1) the size of the United States balance of payments deficit on goods and services, long-term capital outflows, and military and aid expenditures; (2) by the relative attractiveness of short-term investment or borrowing opportunities in different money markets; (3) by speculative anticipations or fears with respect to certain currency par values which may induce massive short-term capital movements and the movement of dollars into foreign official hands.

At any given time, under present circumstances, a substantial gold outflow does not necessarily reflect a worsening in the United States deficit position. It does indicate that some central bank, or a group of central banks, has acquired dollar holdings which it regards as excessive in relation to its gold holdings. Even if the United States has no over-all deficit, it may lose gold if a country maintaining a relatively high ratio of gold to dollars in its official reserves gains reserves at the expense of a country that maintains a relatively low ratio.

## **The International Monetary Fund and Reserve Deficiencies**

Reserve deficiencies have plagued many countries since the close of World War II. Whatever the cause, a decline in foreign money reserves can be serious in that it may force the country facing the reserve problem to adopt measures to stem the decline in reserves. Countries with large reserves are of course able to adopt less stringent measures for correcting payment imbalances.

An important defense for the international payments system is the International Monetary Fund established in 1945. This institution extends short-term financial help to countries in temporary balance-of-payments difficulties.

Its resources consist of gold and currencies of the individual member countries paid in by each member as its subscription. Each country's quota is determined by its relative importance in international trade, population, and national income.

Drawings from the Fund (purchases of another currency from the Fund by deposits of the borrowing member's currency) are almost automatically approved for the first 25 per cent of a country's quota, with subsequent drawings contingent upon presentation of evidence that the country concerned is taking the necessary steps to eliminate the payments imbalance. Repayment generally is in the form of "repurchase" of the country's own currency with gold and convertible currencies, in more or less the same proportion as the composition of the increase in the borrowing country's reserves. The obligation incurred by a drawing must be discharged within a period not exceeding 3 to 5 years.

Because of the postwar importance of the United States dollar in international payments, 90 per cent of the gross drawings from the Fund from 1947 through 1959—or \$3.1 billion out of \$3.4 billion—consisted of United States dollars. As other currencies have become convertible, however, this pattern of drawings has altered. Less than 40 per cent of the \$780 million in drawings from January 1960 through July 1961 has been in United States dollars, 25 per cent has been in German marks, and 15 per cent in British pounds sterling.

### **Some New Features of the International Payments System**

Against the background of massive capital movements, sharply changing foreign reserve positions, and strains imposed on the exchange rate structure, the monetary authorities of the leading free nations reached two important agreements in 1961. The purpose of these agreements was to provide additional reserves to nations experiencing reserve deficiencies.

The first of these developed in March of 1961 when large capital outflows from London to the Continent seriously depleted Britain's foreign exchange reserves and swelled the dollar holdings of Continental central banks beyond normal limits.

To meet this problem, the Continental central banks extended short-term credits of approximately \$900 mil-

lion to the Bank of England. These loans provided England with supplementary reserves to continue her defense of the pound; and they allowed her time to prepare for more basic adjustments in her payments position and to arrange for a drawing from the International Monetary Fund.

The large British IMF drawing of \$1.5 billion in nine currencies in August of 1961 sharply reduced the IMF holdings of particular currencies now in strong demand. After this large transaction, the Fund's holdings of the nine currencies were reduced from \$5.1 billion to \$3.8 billion, of which \$2.1 billion were in United States dollars. The Fund's aggregate holdings of the principal currencies, other than dollars or sterling, have been reduced to the point where large drawings are virtually precluded without large sales of the Fund's gold.<sup>3</sup>

Recognizing the importance of the Fund in meeting short-run reserve deficiencies, ten industrial countries, including the United States, agreed, subject to Congressional or Parliamentary ratification, to participate in new borrowing arrangements in which the Fund would be permitted to replenish its reserves of particular currencies by borrowing such currencies up to certain stipulated amounts. This agreement is of special significance to the United States. If the United States were to experience a massive capital outflow, its gold reserves could decline sharply as foreign central banks accumulated dollars and sold the excess dollars for gold. To avoid this decline in reserves, the United States might draw on the Fund (borrow particular currencies—such as German marks and French francs).

The United States could use these currency balances to buy excess dollar holdings from foreign central banks and also to buy dollars from the exchange dealers seeking to convert dollars into other currencies. The sale of borrowed currencies would curb the increase in dollar liabilities to foreign central banks and the consequent gold loss. The United States drawing would, of course, increase dollar liabilities to the Fund but this liability does not pose the threat against United States gold reserves.

These developments, together with the strengthening of cooperative ties among central banks as evidenced by the recent agreement between the Federal Reserve and the Bank of France, offer considerable hope for a strengthened payments system. They do not, however, constitute a solution to the basic problems of deficits and surpluses.

<sup>3</sup> To date, British repayments on the 1961 IMF drawing amount to about \$700 million.



# Prospective Crop Plantings—1962

**T**HE NATION'S FARMERS as of March 1 planned to plant about 306 million acres of crops for harvest in 1962, or 1.4 per cent less than last year, according to the United States Department of Agriculture. An analysis of 17 major crops indicates that the number of acres planted this year will be only slightly less than last year but will be 10 per cent below the 1951-60 average.

Total acreage of the four feed grain crops (corn, oats, barley, and sorghums) is expected to be a fraction of a per cent below that of 1961 and 16 per cent below the 1951-60 average. Decreases in oats and barley acreage this year are expected to be partially offset by increases in corn and sorghum plantings. Corn acreage may be about 3.5 per cent above the 1961 level and sorghum about 2 per cent higher. Oats and barley acreage may be down about 6 and 4 per cent, respectively.

Food grain acreage is expected to be about 9 per cent less than in 1961. Indicated spring wheat plantings of 10.5 million acres are 14 per cent less than last year. Part of the decline, however, may be offset by rye and rice increases of 15 and 10 per cent, respectively.

Oilseed plantings may be up about 1 per cent, with soybeans up 2 per cent and flaxseed up 4 per cent. Partially offsetting these increases are small declines of about 1 per cent in planned acreage of peanuts and cotton.

Tobacco acreage is expected to total about 4 per cent more than last year as a result of increased allotments for both flue-cured and burley. Acreage allotments were increased 4 per cent for flue-cured and 6 per cent for burley and planted acreage is expected to rise proportionately.

## Prospective Plantings in States of the Eighth Federal Reserve District<sup>1</sup>

Crop plantings in the Eighth District states are expected to follow the national pattern, with the exception of feed grains which may be up about 2 per cent in contrast to the slight decline for the nation. Major gains in planned corn acreage for all the Corn Belt states more than offset indicated declines of corn acreage in Arkansas and Mississippi and the declines of other grains throughout most of the district states (see table below).

Acreage of soybeans in the district states may be up 2 per cent, the same as in the nation. Rice and burley tobacco, with 10 and 6 per cent increases, respectively, likewise are expected to parallel national gains. Indicated cotton plantings are down 2 per cent compared to a 1 per cent decline for the nation.

<sup>1</sup> Arkansas, Illinois, Indiana, Kentucky, Mississippi, Missouri, and Tennessee. With the exception of Arkansas, only a portion of each of these states is in the Eighth Federal Reserve District.

Indicated Acreage, Selected Crops Eighth District States 1962

(Percent Change From Planted Acreage 1961)

Area	Corn	Oats	Barley	Sorghums	Soybeans	Rice	Hay <sup>1</sup>	Cotton	Burley Tobacco <sup>1</sup>
Arkansas .....	-13%	- 8%	-0-%	-28%	+ 6%	+10%	- 1%	- 2%	.....
Illinois .....	+ 6	-14	-17	-10	+ 1	.....	-0-	+24	.....
Indiana .....	+ 8	-15	+10	-0-	-0-	.....	-0-	.....	+7
Kentucky .....	+ 3	- 5	-22	-15	- 3	.....	-0-	-0-	+6
Mississippi .....	- 9	- 5	.....	-25	+10	+ 9	- 3	- 2	.....
Missouri .....	+13	-33	-24	- 2	- 1	+10	+ 8	- 2	+6
Tennessee .....	-0-	- 5	-19	-11	- 1	.....	- 2	- 1	+6
Total—Eighth Federal Reserve District States .....	+ 6	-15	-16	- 8	+ 2	+10	+ 2	- 2	+6
United States .....	+ 3	- 6	- 5	+ 2	+ 2	+10	+ 1	- 1	+6

<sup>1</sup> Per cent change 1962 indicated acreage from 1961 harvested acreage.

Source: United States Department of Agriculture, *Crop Production*, March 1962.

# FARM COMMODITY EXPORTS

**A**GRICULTURAL EXPORTS account for about one-fourth of all United States exports, according to a study recently released by the Secretary of Agriculture. Such exports totaled nearly \$5 billion in 1960-61, or about 14 per cent of cash farm marketings.

Exports totaled about one-half the nation's production of cotton, wheat, rice, and dried peas in 1960-61, according to the report. About two-fifths of the output of soybeans and tallow were exported. One-third of the production of tobacco, hops, flaxseed, and nonfat dry milk, one-fifth of dried whole milk production, and one-sixth of the feed grains sold off the farms moved into the export market. Also, substantial quantities of fruits, poultry, and meat were exported.

Imports of farm commodities totaled about \$3.6 billion during the year. About half of this total was commodities which are not grown in the United States, such as bananas, coffee, tea, rubber, cocoa, and spices.

## *Exports from States of the Eighth Federal Reserve District<sup>1</sup>*

The Eighth Federal Reserve District is greatly dependent upon exports as a market for many of its commodities. In the fiscal year 1960-61 exports from the district states totaled about one-sixth of cash farm marketings, or a somewhat larger percentage than for the nation. Based on the individual state's contribution to national sales or output of specific commodities, all district states with the exception of Tennessee had exports exceeding \$100 million (see table below).

As a per cent of total cash farm marketings the cotton-producing states of Arkansas and Mississippi rank highest, with export equivalents approaching one-fourth total cash farm marketings in each case. Export equivalents were in excess of 10 per cent of cash farm marketings in all the states and averaged 17 per cent compared to 14 per cent for the nation.

<sup>1</sup> Arkansas, Illinois, Indiana, Kentucky, Mississippi, Missouri, and Tennessee. With the exception of Arkansas, only a portion of each of these states is in the Eighth Federal Reserve District.

### Value of Agricultural Exports United States and States of the Eighth Federal Reserve District Fiscal Year, 1960-61

(Amounts in Millions of Dollars)

Area	Principal Exports	Agricultural Export Equivalents*	Cash Farm Marketings	Agricultural Export "Equivalents" as per cent of Cash Farm Marketings
Arkansas .....	Cotton, soybeans, & rice	\$ 171	\$ 687	25%
Illinois .....	Soybeans, corn, wheat & livestock products	320	2,057	16
Indiana .....	Soybeans, wheat, corn & livestock products	149	1,160	13
Kentucky .....	Tobacco, wheat and livestock products	101	585	17
Mississippi .....	Cotton, soybeans, and livestock products	137	617	22
Missouri .....	Soybeans, wheat, cotton & livestock products	154	1,122	14
Tennessee .....	Cotton, tobacco, soybeans & livestock products	93	509	18
Total—Eighth Federal Reserve District States		\$1,126	\$ 6,738	17%
Total—United States.....		\$4,947	\$34,513 <sup>a</sup>	14%

\* The "equivalent" shares were derived from the states' contribution to national sales or output as determined from census data.

<sup>a</sup> Alaska and Hawaii excluded.

Note: Detail may not add to totals due to rounding.

Source: United States Department of Agriculture release, *State-by-State Agricultural Export Study*, February 19, 1962.  
United States Department of Agriculture, *Farm Income Situation*.

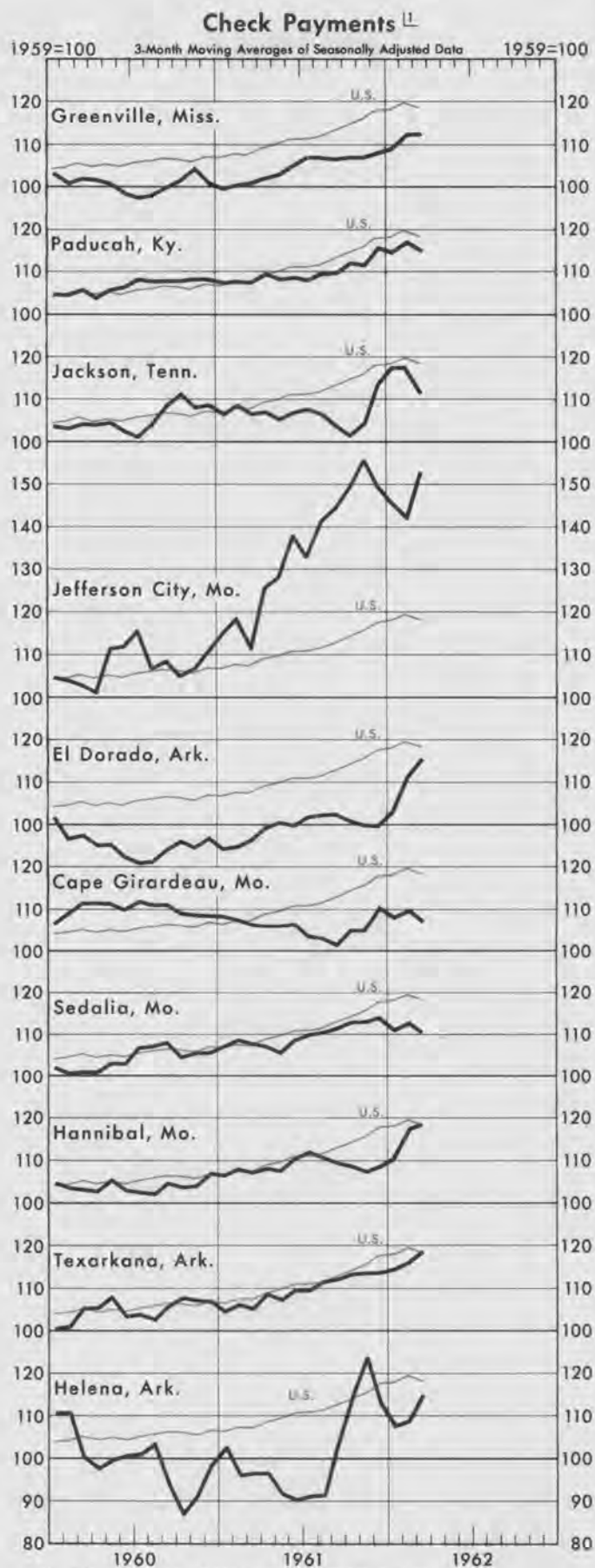
# Check Payments

**B**ANK DEBITS, i.e., the dollar volume of check payments and other charges to bank demand deposit accounts, are a commonly used indicator of business activity. The accompanying charts compare the movements of bank debits at ten medium-sized centers in the Eighth Federal Reserve District, seasonally adjusted, with the movement of bank debits at the 343 reporting centers in the nation (exclusive of New York City). In order to reduce the wide monthly fluctuations in the series, a three month moving average has been applied to the data. In the April 1962 issue of this *Review*, the movements of bank debits for the ten largest reporting centers in the District were compared with the national series.

Check payments at the 343 reporting centers were about unchanged from early 1960 to early 1961. This stability of bank debits reflected in large measure the 1960-61 recession. From the February 1961 trough to March 1962 the volume of check payments increased at an annual rate of 13 per cent.

Debits at the Eighth District reporting centers illustrated on the accompanying charts had a diverse pattern. The movement of bank debits at most of the centers was substantially different from the movement of debits nationally. Business activity at these centers reflect largely local and regional developments.

Bank debits are one of the best available indicators of business conditions for many localities. However, there are limitations to the use of these data, and whenever possible, they should be used in conjunction with other measures of local business activity. Several of the more important limitations are the large and varying amounts of: (1) financial transactions unrelated to production and consumption, (2) transactions from outside the area, (3) expenditures not resulting in debits, and (4) outlays recorded several times.



<sup>1</sup> Debits to demand deposit accounts, except interbank and U.S. Government accounts.  
U.S. figures are for reporting centers outside New York.  
Latest data plotted: March, which includes estimated April data.