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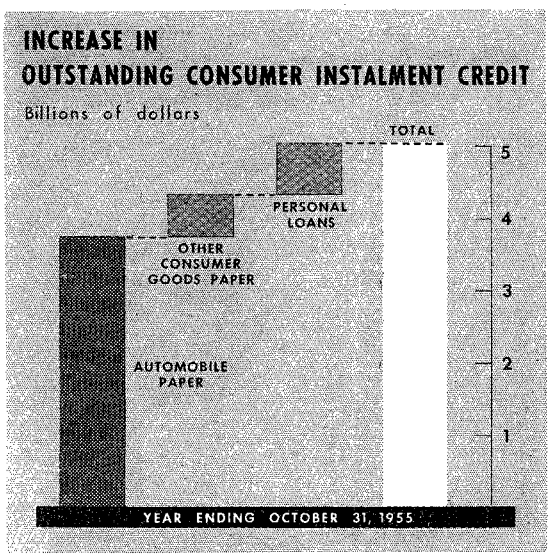
GROWTH OF CONSUMER INSTALMENT CREDIT

An increase of 5 billion dollars in consumer instalment credit over the past year has been an important factor in the upswing in economic activity. Automobile paper accounted for most of the growth, as the chart shows. The remainder was shared about equally by other consumer goods paper and personal loans. At the end of October, outstanding instalment credit amounted to 27 billion dollars.

Rapid expansion in instalment credit has reflected a sharp rise in new loans extended, accompanied by a moderate growth in repayments. Extensions, which were at a monthly rate of about 2.4 billion dollars seasonally adjusted in the late summer of 1954, began to expand in the closing months of the year. They reached a record rate this September of 3.3 billion dollars and then declined in October. Repayments rose more slowly over this period, from a monthly rate of about 2.4 billion dollars to 2.8 billion in October of this year. Changes in repayments typically lag behind changes in extensions, and the lag this year was greater than usual because a lengthening of maturities on new contracts reduced average monthly payments relative to credit extensions.

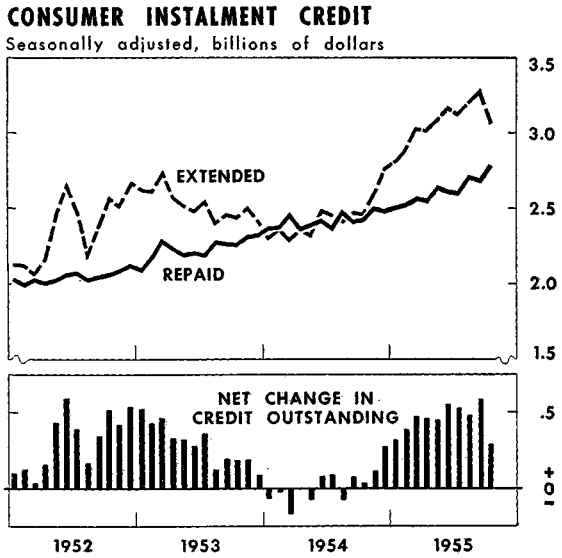
Commercial banks and sales finance companies provided most of the additional instalment credit. Banks increased their own instalment loans and also advanced funds to other instalment lenders and retail stores to finance increases in their receivables. In addition to increased borrowing at banks, finance companies borrowed substantially through sales of debentures and commercial paper to nonbank investors. The large and persistent demand for consumer credit was a factor, along with increased demands for many other types of credit, in the general tightening of credit markets and the rise in interest rates during the year.



NOTE.—Repair and modernization credit, the only component not shown, decreased 10 million dollars.

INSTALMENT CREDIT AND CONSUMPTION EXPENDITURES

Extensions of instalment credit provide consumers with additional current buying power, while repayments of loans reduce



NOTE.—Latest figures shown are for October.

their buying power. Extensions have been substantially in excess of repayments this year, as shown in the accompanying chart. In October, however, the gap between the two narrowed as extensions declined and repayments increased further.

During the first ten months of this year the amount of instalment credit extended was 7 billion dollars larger than in the same period of 1954, while repayments increased about 2 billion. Thus, expansion of instalment credit made available about 5 billion dollars more for consumption expenditures than during the corresponding period of 1954. This increase contributed to the marked growth in consumption expenditures.

The impact of the rapid increase in extensions of instalment credit has been primarily on markets for automobiles and other consumer durable goods—the major types of goods purchased on an instalment basis. While the rise in repayments has led to some reduction in funds available to consumers, the effects on markets for specific products are not readily traceable.

SHORT- AND INTERMEDIATE-TERM CONSUMER CREDIT OUTSTANDING

[Estimates, in millions of dollars]

Type of credit	Amount Oct. 31, 1955	Increase, or decrease (−), year ending October 31—		
		1955	1954	1953
Instalment credit	**26,963**	**5,011**	**186**	**4,155**
Automobile paper	14,095	3,755	−33	2,743
Other consumer goods paper	5,917	593	−205	634
Repair and modernization loans	1,627	−10	18	257
Personal loans	5,324	673	406	521
Noninstalment credit	**7,677**	**654**	**189**	**298**
Single-payment loans	2,666	289	178	174
Charge accounts	3,218	326	6	97
Service credit	1,793	39	5	27
Total consumer credit	34,640	5,665	375	4,453

Automobile credit. Sales of new autos at a record rate of about 7.5 million units this year have been associated with a marked growth in automobile credit. Credit began to expand sharply when the 1955 models came on the market late in 1954. Since March extensions on a seasonally adjusted basis have averaged about 1.5 billion dollars monthly, as compared with a monthly average of 1.1 billion in the fall of 1954. Over the past ten months, automobile credit extensions totaled 15 billion dollars, about 5 billion or 45 per cent more than in the same period last year. This compares with an increase of 40 per cent in number of new autos sold in the same period and a substantial increase in sales of used cars.

Growth in both cash and credit sales contributed to the record volume of new car sales this year. Cash sales of new cars increased more rapidly than credit sales immediately after the introduction of the 1955 models late in 1954, but in the spring and summer the greater increase was in credit sales. This pattern—strong cash sales early in the model year, with credit sales gaining in importance toward the end of the model run—has characterized recent years.

Credit sales in the first quarter of 1955 were less than three-fifths of all new car

sales, while in the third quarter nearly three-fourths of new cars were sold on credit. These proportions are a little higher than in the corresponding periods a year earlier, as is shown in the accompanying table.

PERCENTAGE OF NEW AUTOMOBILES SOLD ON CREDIT

Period	1955	1954	1953	1952
1st Q.	57	55	59	63
2nd Q.	63	56	57	58
3rd Q.	72	70	59	67
4th Q.	—	65	68	68

The high level of both cash and credit sales of new automobiles this year has reflected a number of special factors. Public response to the 1955 models was enthusiastic. Substantial price discounts, stemming from strong competition among producers for a larger share of the market, have been particularly important. Moreover, credit sales have been stimulated by lower down payments and longer maturities, particularly on new cars.

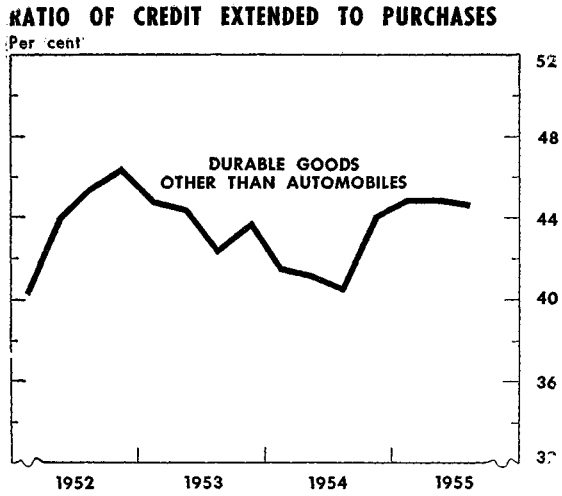
By midsummer 30-month instalment contracts on new automobiles were typical as compared with 24-month contracts a year earlier. Contracts with 36-month maturities have become fairly common and some 42-month contracts have been reported. Although most lenders still require down payments of one-fourth to one-third of the transaction price, over-allowances on trade-ins and other practices have reduced the real down payments of many credit buyers of new cars sharply below these standards. Over-allowances on trade-ins may be partly offset by "packing," or inflating, the retail price suggested by the manufacturer. In any case the nominal down payment may overstate the real down payment with the result that the buyer's equity may in fact be quite small.

Lower down payments and higher finance and insurance charges associated with longer maturities, together with the increased demand for optional equipment and a trend toward purchase of more expensive cars, have been reflected in an increase in the average size of instalment notes on new car contracts. In October the average instalment note was $2,200 as compared with about $2,000 a year earlier. This increase has also been a factor in the rise in credit extensions.

Other consumer goods credit. Instalment credit has also been important in this year's active markets for consumer durable goods other than automobiles. In recent years more than half of the purchases of furniture and major household appliances has been financed through instalment credit. Although the growth this year in purchases of these goods has been more moderate than that for automobiles, such expenditures reached a new high in the third quarter and are expected to be at a record level for the year as a whole.

Total extensions of credit on furniture, appliances, and other consumer goods were about 1.1 billion dollars greater during the first ten months of this year than during the same period of 1954, and the proportion of purchases on credit increased somewhat. As the chart on the following page shows, the ratio of credit extended to purchases of consumer durable goods other than automobiles during the third quarter of this year was about 45 per cent as compared with 40 per cent a year earlier.

Purchases of furniture and household appliances, both for cash and on credit, have been stimulated by many factors. Prices have become more attractive in many lines as competition among sellers led to special sales and other promotional activities. The high level of disposable personal income and



NOTE.—Quarterly figures on purchases used in computing ratios are Federal Reserve estimates based on Department of Commerce annual estimates of consumption expenditures for durable goods other than automobiles and quarterly data (Commerce and Federal Reserve) on sales of such goods.

the record rate of sales of both new and old homes also have contributed to the demand for these goods.

Instalment purchases of all types of consumer goods have received some impetus this year from the further development of "revolving credit" and similar plans. Such plans permit the customer to make a series of purchases on the same account without changing his rate of repayment or receiving a separate credit clearance for each purchase. The National Retail Dry Goods Association reports that about two-thirds of the larger department stores offered a revolving credit plan at the beginning of 1955 as compared with about two-fifths in 1950.

Other instalment credit. Personal instalment loans have increased steadily for more than ten years. This year the rate of growth has accelerated slightly. This type of credit provides funds for a wide variety of purposes, including consolidation of consumer debts, payment of medical expenses, and some purchases of consumer goods.

Repair and modernization credit, which is often used for purchases of household equipment in connection with major alterations of homes, has not shown the upward trend characteristic of most other types of consumer credit during the past year. The amount outstanding leveled off in early 1954, following several years of steady growth, and since that time has shown little change.

Economic Factors Influencing Credit Expansion

The favorable financial position of consumers, the high level of output and sales of automobiles and other consumer durable goods encouraged by vigorous selling efforts, and the availability of credit on liberal terms have all contributed to the rapid expansion in instalment credit this year.

Consumer incomes, which were relatively high at the beginning of 1955, increased further as employment rose and wages and most other types of personal income increased during the year. These developments tended to reinforce the optimism consumers had expressed early in the year when the Board's Survey of Consumer Finances was taken.

The large volume of purchases of automobiles and other consumer durable goods stemmed in part from intensive efforts of retailers and manufacturers to expand their sales. At both levels there was widespread reliance on promotional campaigns to stimulate demand and to move the record volume of output. Many of these campaigns specifically encouraged the use of credit.

In the consumer credit market, competitive pressure among lenders for instalment business was intense. Lenders were in a favorable position to expand their operations, especially during the early part of the year. Funds were available at relatively low cost and delinquencies and repossessions on

outstanding instalment indebtedness were at a low level.

Sources of Instalment Financing

A large proportion of instalment contracts originate with credit sales of automobile dealers and retail stores, and most such paper is sold immediately to commercial banks and sales finance companies. These two groups of lenders together hold about 70 per cent of all instalment credit outstanding.

Sales finance companies accounted for half of the 5 billion dollar increase in instalment credit outstanding over the past year while the increase in commercial bank holdings accounted for nearly a third. In addition to expanding their own holdings of instalment credit, commercial banks contributed indirectly to the expansion in total instalment credit through increased loans to sales finance companies and other lenders.

Sales finance companies, which specialize in automobile credit, increased their share of total instalment credit outstanding to 32 per cent at the end of October, compared with 29 per cent a year earlier. This change was accompanied by slight declines in the proportions held by commercial banks and retail stores, as shown in the table.

Holders of Consumer Instalment Credit

Type of holder	Amount Oct. 31, 1955 (million dollars)	Percentage distribution		
		Oct. 31, 1955	Oct. 31, 1954	Oct. 31, 1953
Commercial banks	10,145	38	39	41
Sales finance companies	8,771	32	29	28
Credit unions	1,547	6	6	5
Other financial institutions	2,861	11	11	11
Retail stores	3,639	13	15	15
All institutions	26,963	100	100	100

Sales finance companies borrowed substantial amounts in both long- and short-term credit markets. As a group they increased their debt by an estimated 2 billion dollars in the first ten months of 1955. This included more than 1 billion dollars of new debentures, about 500 million dollars in debt to banks—loans and bank-held commercial paper—and about 400 million of commercial paper placed directly with nonbank investors.

Among sales finance companies the methods of financing varied. Five of the larger companies, which have about three-fifths of the instalment debt held by all sales finance companies, accounted for three-fourths of the increase in total long-term debt issues this year and all of the increase in directly placed paper. Banks supplied a smaller proportion of the increased financing needs of the larger companies than of other finance companies.

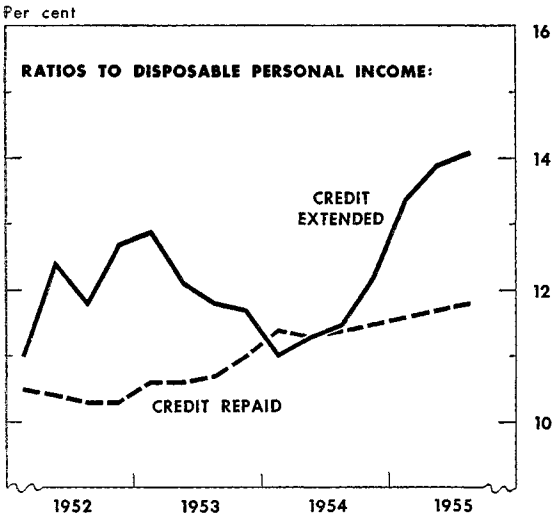
Interest rates on short-term funds borrowed by sales finance companies have risen during 1955, reflecting in part heavy demands of these companies in the credit market during a period when demands for other purposes were also large. The rate on 3- to 6-month commercial paper placed by the larger sales finance companies directly with nonbank investors increased to 2⅞ per cent from 1½ per cent in December 1954, while the rate paid on bank loans by these companies increased to 3½ per cent, from 3 per cent. Rates on commercial paper sold in the open market by smaller sales finance companies increased to as much as 3¼ per cent, from 1¾ per cent at the close of 1954.

Current Situation

Rapid growth in credit extensions and in outstanding consumer instalment credit this year has not been accompanied by a proportionate increase in the burden of repayments. In part because longer maturities have dampened the growth in repayments and in part because incomes have also increased, the

ratio of repayments, including finance charges, to disposable personal income has increased only moderately, as is shown in the chart.

RELATION OF INSTALMENT CREDIT TO INCOME



Moving up gradually after mid-1954, the ratio of repayments to disposable income reached an all-time high of about 11.8 per cent in the third quarter of this year. The small rise in this ratio contrasts with rapid growth in the ratio of extensions to disposable income, which increased from 11.5 per cent to 14.1 per cent over the past year.

The relatively high level of repayments this year has not been accompanied by an increase in the proportion of instalment loans on which payments are delinquent. At commercial banks, for example, delinquent loans as a percentage of all instalment loans held are now less than at any time in recent years. The current favorable experience of lenders reflects in part the high levels of employment and income.

Liberalization of contract terms, particularly on automobiles, has resulted in a reduction of consumers' equities in instalment purchases and an increase in lenders' risks. For example, for a new automobile which is purchased on terms of one-fourth down and 36 months to pay the owner's equity at the end of a year may be as little as 10 per cent of the estimated depreciated value of the car. Under extremely liberal terms the amount of the loan for a number of months may exceed the depreciated value of the automobile purchased.

Efforts of producers and distributors to maintain high levels of output and sales of automobiles and other consumer durable goods continue to exert pressures for increased extensions of instalment credit. On the other hand, funds have become less readily available to instalment lenders, and the rates charged for such funds have increased. Many lenders have taken steps to raise lending standards, and the trend toward further easing of down payments and maturities appears to have slowed.