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WHAT THE MARKETING MAN SHOULD WATCH CONCERNING CREDIT

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WHAT THE MARKETING MAN SHOULD WATCH CONCERNING CREDIT

It is quite customary for businessmen to attempt to discern what the future holds both with respect to physical changes in business activity and as to price trends. They also wonder how their expansion and sales plans will be affected by the national credit policy. Instead of giving you more prophesies, since you are constantly bombarded with predictions, I will reverse the process and suggest what factors should be watched that are likely to influence central bank policy.

The observations will fall into three categories:

(1) Those that have to do with production, distribution and prices;

(2) Those that have to do with the quantitative aspects of money and credit;

(3) Those that have to do with the quality of credit and of business decisions.

To keep abreast of the nonmonetary changes in the economy, the businessman should watch at least six measures. These are:

1. The Federal Reserve Board Index of Industrial Production.

2. Sales data for both manufacturing and retail establishments.

3. Inventories at each of the three levels--manufacturing, wholesale, and retail.

4. Price and wage indices.

5. Employment and unemployment.

6. Gross national product and personal income.

An informative means of visualizing income data is to express them on a per capita, or per family basis. The Office of Business Economics of the Department of Commerce estimates that last year the average (mean) personal income per family was $5,520, of which income taxes took $540, leaving disposable income of $4,980. Incomes and spending have continued to rise this year. Currently, total personal income is 7 per cent above the average for last year and family income is up by almost this percentage. Also up significantly from last year are total consumer spending for goods and services and also the dollar amount and rate of personal saving.

Americans live in about 50 million housing units, and use over 50 million passenger automobiles, 130 million radios, and nearly 40 million television sets. Whether these are necessities or mere gadgets, and whether all of them contribute to a good life need not be debated here; at least we have the physical basis for good living. Underlying the growth in family income and in stocks of houses and consumer durable goods has been a sustained rise in productivity. The increase in output per man-hour has been the joint result of many influences, including technological change, growth of fixed capital, and the skills and attitudes of management and workers. Since the turn of the century, the American manufacturing worker has turned out over twice the goods in one-third less time, and his productiveness may be described as rising about two and one-half per cent per year.

The rise in output per worker and the wide distribution of incomes and assets have enabled a large and growing proportion of our families to enjoy standards of living that--not so many years ago--only the then wealthy could attain. Both the top and the large middle income groups use substantially the same foods, television sets, household appliances, and automobiles. Manual workers enjoy comforts once reserved to kings. In the less material sphere, distinctions arising out of disparities in income are also being blurred. Higher education has become increasingly accessible to all. Upper and lower groups read the same newspapers, see the same movies, and listen to the same music.

The combination of this increased national pile of goods and services, together with the redistribution of incomes by taxation, has led the Twentieth Century Fund to observe that "of all the great industrial nations, the one that clings most tenaciously to private capitalism has come closest to the Socialist goal of providing abundance for all in a classless society."

Turning now to prices and wages, both of which reflect the interplay of the forces of demand and supply, price and wage information is abundantly available for nearly all industries and localities. It is customary to watch sensitive commodities and also more general measures of wholesale prices in order to judge the strength of demands in the economy and also to appraise the implications for future movements of retail prices. Much more difficult to come by in many industries, however, are data as to stocks on hand which, together with output, sales and other data, are essential in evaluating the near-term future.

Money and Credit

All the measures mentioned so far are those with which the businessman has intimate acquaintanceship. But credit and the money supply, though equally fundamental to his activities and well being, are perhaps less tangible and familiar.

On the quantitative side, changes in the money supply are fundamental. Anyone who wishes to determine whether the money supply is being increased or decreased, and at what rate, may watch changes in seasonally adjusted money supply from the Federal Reserve Bulletin. Other data are provided in the Bulletin for those who wish to follow both nonfinancial and financial developments. Thus, one may observe not only changes in the total use of credit but also changes in its composition. He may keep track of changes in mortgage debt--both nonresidential and residential--other consumer debt, including instalment debt, and bank loans to industrial and commercial establishments that reflect the needs for inventories and working capital.

Of special relevance is the amount of borrowing done by member banks at the Federal Reserve Banks, which shows up in the discount and advances figure week by week. Highly significant in the view of many observers is the volume of so-called free reserves, which represents the algebraic difference between the excess reserves that commercial banks must hold and the aggregate amount borrowed by them from the Federal Reserve Banks. During periods of the business cycle when demands for credit are relatively low and the Federal Reserve is making an effort to stimulate business recovery by adding to bank reserves and easing credit, this figure will be a positive one. During times of boom when the Federal Reserve System feels it necessary to restrain speculative exuberance and excessive loan demand, the figure will be a negative one, i.e., commercial banks will, as a group and on a net basis, be indebted to the Federal Reserve Banks.

In this last case the figure may appropriately be called net borrowed reserves. As to the price of money, the businessman is, of course, most directly concerned with the interest rate he himself must pay on money he borrows. In addition he may well watch market quotations on both long-term and short-term securities, since from those he may be able to discern trends toward tightening or easing in the general availability of funds. Of particular significance in this connection are the discount rates charged by the Federal Reserve to their member banks. A change in the discount rate usually means that the Federal Reserve believes interest rates, which are the price one pays to rent somebody else's money, have already changed sufficiently to justify a change in the price which commercial banks should pay when they borrow from their bank of last resort. A change in the discount rate may also signal that the Federal Reserve is attempting to stimulate business or to keep it within sustainable bounds. The central bank speaks through actions. It guards against too many pronouncements and is economical in its use of words lest they be misunderstood and misinterpreted. Discount rate changes represent one of the few monetary indicators that reach the front pages.

Quality of Credit and of Business Decisions

Turning now to the qualitative side of credit, businessmen may well ponder from time to time some indicators that reflect the carefulness and prudence of both lenders and borrowers. An essential balance that is frequently lost sight of is that between equity and debt. When equity becomes thinner, as happens when down payments are lowered and repayment periods are stretched, the quality of that credit is weakened. The most fundamental test of quality is the ability of the borrower to repay. In the case of a loan to a business, this test is met by a consideration of the use to which the credit is put and the additional product and profit that will result. If the purpose of the loan is productive and promises to be profitable, then the loan may be said to be credit-worthy. In the case of a consumer, on the other hand, the quality test must be met in a different way. Many loans to consumers, indeed, are for purposes that do not result in the acquisition of a marketable asset. Thus consumers may borrow merely to provide pleasure, such as for foreign travel. For loans of this type, quality necessarily depends on the character of the borrower, on his income, and on the nature of his financial responsibilities and resources.

Still another gauge of quality consists of the lending terms. You will note that the stretching of terms is related to the thinning of equity. For example, when the terms of automobile paper dropped last year from 1/3 down and 30 months to pay to 1/4 down and 36 months to pay, the equity of the car buyer at the end of one year dropped from 30 per cent to 10 per cent of the depreciated value.

I have attempted to indicate how one may keep aware of the economic traffic that flows around him. A related question is: What are the "rules of the road" that enable this traffic to move fast but safely?

Perhaps the most fundamental of them is the preservation of balance and proportion. The economy needs a nice balance between protection ~~production~~ and risk, between caution and daring, between liquidity and the expansion that borrowing makes possible. What is needed is neither the excessive conservatism that inhibits adventure and growth nor actions based upon mere speculation. In the short run, the use of resources for increasing productive capacity and for increasing the consumption of goods and services must be kept in balance. In the long run, the important consideration is to foster the highest sustainable level of economic growth so that productive capacity may keep up with the needs of an expanding population for both more goods and more jobs.

In short, the goal of economic growth without inflation calls for business decisions of high quality. Such decisions are marked by prudence, discretion and hard-headed common sense, unaffected by speculative fever and thoughtless competitive rivalry. The business and governmental decisions of this year will color the business situation next year and in the year beyond.

As Mr. Eugene Meyer, who has in the past headed the Federal Reserve Board and the Reconstruction Finance Corporation, and now the Washington Post-Times Herald, observed over a third of a century ago, "Over-expansion, inevitably and always, is characterized by over-confidence and its impelling power is found in cupidity . . . If one could plot the curves of optimism and pessimism as exactly as one can plot the curves of prices and the volume of production and consumption, one would find that they fall considerably behind the material conditions. Only the few anticipate events; the many stop, look and listen after the event is past."