

Date August 19, 1943To Mr. ThurstonFrom Mr. Parry

MESSAGE: The gist of it is that these SEC studies are going to Goldenweiser's Division (Miss Burr's section), that this particular one is tied in with a lot more, that you have to do a lot of digging, in collaboration with SEC, to get at the meaning of the figures and test the validity of the conclusions, and that they have been engaged on this job for some time and are still engaged on it.

If you want all this spelled out in technical detail, ask me for the memorandum of Mr. Dirks to me dated August 16.

Would like to see it.

Shank

Message delivered by _____

Referred to Messrs

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CEP

Mr. Parry:

The Chairman asks
me to ask you whether
we are (you are) getting
the S.E.C. studies, of which
the attached is but
one, & also whether you
think the material is
worth while - particularly
what you think of the
conclusions stated (if any)
Shanks, Et

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

file
Office Correspondence

Date August 16, 1943

To Mr. Parry

Subject: Analysis of corporate liquidity

From Mr. Dirks *FD*

by the SEC and by ourselves

You have referred from Mr. Thurston to Miss Burr a memorandum by Irwin Friend of the SEC dated July 10, 1943. This memorandum presents figures and comments on the tendency of nonfinancial corporations toward increasing liquidity "which began in 1942 and which may be expected to continue throughout the war". The estimates of corporate cash are based on direct reports which the SEC gets quarterly from about 1200 or 1300 companies. The memorandum also contains quarterly estimates of Government securities, inventories and tax liability which appear to be derived from series reported by other Government agencies.

Several of us in the Research Division are in touch with the current results of SEC work in this general field and we are also pushing further studies that seem needed to interpret correctly the financial aspects of corporate business activity. Some of our work supplements phases of the SEC tabulations which we feel to be weak, while other parts of our work are breaking new ground. As in the case of the SEC, our progress is a little limited by the amount of personnel available for this work.

Usefulness of data on business cash

For the purpose of estimating changes in business cash in various industrial groups, the SEC estimates are undoubtedly a useful supplement to the Board's bank deposit surveys. The SEC data approach the subject from the corporate side, while the Board's approach is from the banking side. Both approaches run into some uncertainties and estimating errors, and a comparison of their results is likely to lead to more accuracy than can be obtained by either approach alone.

As regards the worthwhileness of estimating the ownership of business cash, it may be observed that these data are highly suggestive for Government fiscal and credit policy, but they need to be supplemented by further studies. At first sight, the recent figures suggest that corporate business will not need to do much new bank financing during the rest of the war, but instead will be able to absorb considerable amounts of Government securities. Furthermore, the data suggest an accumulation of liquid funds that could go far to finance post-war reconversion without recourse to special Government credit aids, provided the Treasury will be in a position to make large-scale redemptions of its securities.

The possibility of drawing such inferences from present data on business cash is subject to several limitations. In the first place, currently available data show only the gross increase in business cash, whereas the significant aspect for wartime fiscal policy is rather the amount that can be tapped for Government use -- that is, the amount that is in excess of working capital requirements. Since these requirements increase with the expansion of war production, a mere increase in business deposits does not necessarily indicate idle funds.

Secondly, as regards the post-war disposition of these accumulated balances, it seems unlikely that they will be distributed among various companies precisely in accordance with spending needs. This means that some companies will probably retain much of their present investment in Government securities, while many others will need more funds and will have to turn to the banks, to security markets, or to Government credit agencies.

When the SEC memorandum comes to the possibility of forecasting future changes in corporate liquidity, it seems over-sanguine. The author states that the financial position of corporations at the end of the war will depend mainly on how long the war lasts. This view implies a stability in the recent trend and seems to overlook the fact that recent increases in liquidity stem from various sources, some of which are inherently self-limiting; for example, the provision of Government funds to free corporate funds previously invested in manufacturing inventories, the accumulation of reserves for renegotiation of war contracts, and the accumulation of funds resulting from inability to get materials for maintenance and replacements. Forecasting future developments in such items will involve detailed analysis of corporate financial statements.

Thus, while data on the ownership of bank deposits and on corporate cash balances contain important implications for the banking system and for Government fiscal and credit policy, their correct interpretation will call for a good deal of supplementary analysis.

Studies under way at the Board

Here at the Board, two sections of the Research Division are conducting work in the general field referred to in the SEC memorandum of July 10. The analysis of sources and uses of funds by about 100 manufacturing corporations was begun in the Capital Markets Section by Mr. Hersey six or seven years ago. The number of corporations covered in this way has been expanded recently to 800 companies (for the period beginning 1935) and data for 350 companies have already been tabulated through 1942. These represent about 40 per cent of all manufacturing production. We are working now on analysis of the data for these companies and are making

comparisons with other series relating to total war production, capital expenditures, inventories, etc. To accompany these data for manufacturing, we have made similar analyses of sources and uses of funds for railroads and other public utilities.

This work is similar to that which Mr. Friend's memorandum indicates is under way at the SEC. However, the amount of analysis that could and should be made of these data is so great that no serious duplication of effort is anticipated.

The ownership of bank deposits is now being surveyed in a systematic fashion through special reports from cooperating banks which are being analyzed in our section on Banking Statistics. These data cover unincorporated business and personal accounts, and hence are broader than those of the SEC which relate only to corporations. Complete reconciliation of the results of the Board's survey with the SEC data is not yet possible because of various conceptual and statistical differences. The sections on Banking Statistics and on Capital Markets are cooperating in investigating these differences under the following headings:

1. amount of funds in transit among businesses and among banks;
2. amount of cash balances held by corporations in industries other than manufacturing and trade;
3. amount of funds held by corporations under accounts other than "cash";
4. amount of funds held by unincorporated business.

The first of these questions is being studied jointly with members of the SEC staff. The second study represents a partial duplication of SEC effort which we are undertaking because of questions as to the statistical adequacy of their estimates.