(Left with Senator Taft)

1/21/48

CREDIT EXPANSION AND INFLATION

Bank credit expansion is now helping to finance continued inflation. This is true because business expenditures are exceeding business receipts and businesses are finding it necessary to borrow for expansion of plant and equipment and to meet increased working capital requirements. These borrowings, together with the borrowings of consumers and real estate owners, have been in excess of the supply of current savings available for investment. Businesses and individuals, therefore, find it necessary either to draw upon past savings or to borrow from banks. To the extent that past savings are used, the velocity of the existing money supply is increased. To the extent that funds are borrowed from banks, the total supply of money is expanded.

Funds to meet the increased credit needs are being obtained in part through sales of securities by banks, insurance companies, and perhaps other investors to the Federal Reserve System. Federal Reserve purchases of securities increase the supply of bank reserves and permit a multiple expansion of credit on the basis of the reserves provided.

Borrowing from banks by businesses and consumers is offsetting the anti-inflationary effects of the Government surplus and retirement of the public debt held by the banking system. The total of demand deposits and currency, which were reduced through Treasury surplus by 3.5 billion dollars in the first quarter of 1947, were increased by nearly 7.5 billion dollars through bank loan expansion during the remainder of the year. One of the most powerful anti-inflationary forces would be the continuance of a Treasury surplus but this, of course, will be weakened by prospective tax reductions.

In view of the heavy demand for capital from business, Treasury savings bonds drives cannot be relied upon to absorb existing savings and reduce inflationary pressures. In addition to continued Treasury surplus, the proceeds of which are used to retire Federal Reserve held securities, action to restrict the supply of reserves available to banks is the most effective anti-inflationary weapon that may be used under present conditions.