

Financial Developments in 1947 and Early 1948

Inflationary forces continued to dominate the nation's economy during 1947 and the early months of 1948.

Total demand by consumers, businesses and government, based on rising incomes, on the use of previously accumulated savings, and on new borrowing, exceeded the capacity of the economy to supply goods and services. Aggregate output, which at the beginning of 1947 was larger than in any previous peacetime period, showed little further growth in the course of the year. Prices rose under the pressure of vigorous demands, and the total value of the nation's product of goods and services continued to increase. Employment was close to a maximum level possible with the existing labor force. The large volume of employment, rising wage rates, high prices for farm products, and large profits by businesses were reflected in a further growth of national income.

Consumer expenditures, which had necessarily been less than income during the war period because of the scarcity of goods available for purchase and the effect of rationing and price controls, increased after the war more rapidly than personal incomes. This reflected the increased availability of goods and the willingness of many consumers to spend freely notwithstanding sharply advanced prices. Many consumers drew upon their large wartime accumulations of savings and others borrowed to supplement current income. Although current personal savings were considerably below the abnormally high wartime level, individuals in the aggregate continued to add to their holdings of liquid assets.

Heavy business expenditures for equipment, plant, and inventories, prompted by expanding markets and increased earnings, added to the total volume of buying. Farmers, with incomes at record high levels, were likewise active buyers of equipment, as well as of consumers' goods. There was also a sharp expansion in expenditures of State and local governments. Growing domestic expenditures were reinforced by exceptionally active demand for American goods from abroad, reflecting acute needs on the part of war-ravaged Europe and large purchasing power on the part of other countries.

Expenditures by the Federal Government in 1947 were an important factor in total demand, as measured by peacetime standards, although somewhat smaller than in 1946. At the same time, Government cash receipts exceeded cash payments, and a substantial amount of Government securities was retired.

In 1947, particularly in the last half, there was a substantial further increase in the demand for bank credit and for investment funds. Offerings of corporate securities increased rapidly and those of State and local government issues continued in large volume. There was a growing demand for mortgage and consumer credit, as well as for commercial loans. Bank loans, which increased moderately in the first half of 1947, expanded sharply in the last half of the year. For the year as a whole total loans of all commercial banks increased by more than 7 billion dollars and their holdings of securities of State and local governments and corporations increased by about a billion dollars.

Expansion in private bank credit was primarily responsible for a further large growth in 1947 in the already over-large volume of money in the hands of business and individuals. Total deposits and currency, excluding Government deposits, increased over the year by almost 6 billion dollars.

In an attempt to restrain inflationary bank credit expansion, measures were undertaken by the Federal Reserve System and the Treasury, acting in cooperation, to reduce the availability, and increase the cost of bank credit. These official measures, coupled with the growing demand for funds, resulted in a rise in money rates and bond yields during the last half of 1947. In October this movement began to affect the Government bond market. During part of November and December, the Federal Reserve and the Treasury through limited purchases supported prices of Government bonds at the levels they had reached in the market, which were in most cases still substantially above par. On December 24 prices of Treasury bonds were permitted to decline to a new level, which maintained the 2-1/2 per cent yield on the longest-term Treasury bond and yields on other issues at appropriate levels in relation to this rate and to the 1-1/8 per cent rate on Treasury certificates. The Federal Reserve System became an active buyer at the new level.

Large amounts of Treasury bonds were purchased by the Reserve Banks during December 1947 and the early weeks of 1948 in providing support to the market. A substantial portion of these purchases were from insurance companies and other institutional investors and some were from banks. At the same time banks, as well as other investors, increased their holdings of Treasury bills, certificates, and notes.

In the second week of January 1948, as a measure of restraint upon the use of Federal Reserve Bank credit, the Federal Reserve Banks increased their discount rates on advances to member banks from 1 to 1-1/4 per cent. The Board of Governors also took action late in January to increase from 20 to 22 per cent, effective February 27, 1948, the reserves required to be maintained against net demand deposits by member banks in central reserve cities (New York and Chicago). The requirement for banks in these cities had been at 20 per cent since the latter part of 1942, when it had been reduced from 26 per cent, the maximum permitted under existing law.

In view of the expanding volume of bank lending and the accompanying inflationary developments, the Federal and State bank-supervisory agencies issued in November a joint statement urging banks to curtail speculative loans, to guard against over-extension of consumer credit, and to confine financing to loans which would help production and not merely increase consumer demand.

Toward the end of 1947 the American Bankers Association sponsored an organized effort by banking leaders to encourage voluntary restraint on inflationary bank credit extension among the country's 15,000 commercial banks. To the extent that individual banks restrict voluntarily their lending and investing programs, anti-inflationary monetary and supervisory policies pursued by the Federal Reserve System and the Treasury are reinforced and made more effective. Such voluntary action to be effective in restricting credit expansion requires the adoption by individual banks of rigid standards in all lending operations, with a view to preventing further expansion in the total volume of bank deposits as well as avoiding loans that may involve a high degree of risk.

Expansion of bank loans has continued in 1948 but at a slackened pace. Total bank loans increased about three-quarters of a billion dollars in the first quarter of the year. Growth in loans during these months was larger in 1948 than in 1946, a year of near record loan expansion, but was somewhat smaller than in 1947.

Slackening in bank loan expansion is due largely to a small decline in loans to businesses, whose demand for bank credit are usually reduced in this season. Bank loans to real estate buyers and to consumers have continued to expand.

Privately-held deposits and currency declined about 4 billions during the first quarter of 1948, reflecting the large surplus of Treasury cash receipts over expenditures. Further expansion in bank loans and gold inflows tended to offset in part, however, the contractive effect on the money supply of Treasury operations.