

For Release on Delivery  
7:00 p.m., Pacific Time  
October 19, 1956.

THE PURCHASING POWER OF THE DOLLAR

Address by C. Canby Balderston,  
Vice Chairman, Board of Governors of the Federal Reserve System,

Before the Fifty-fifth Annual Convention  
National Association of Supervisors of State Banks

San Francisco, California,

On Friday, October 19, 1956.

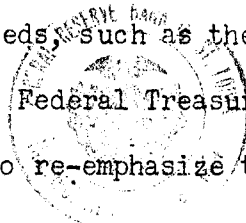
## THE PURCHASING POWER OF THE DOLLAR

Money is tight and the reasons need to be understood. At stake is the protection of the buying power of the dollar. At stake also is the stretching out of the present period of high prosperity and employment.

Fortunately the long future of our economy is one of rich promise. Thanks to technological advance and population increase, the long-term prospects are superb. The wide recognition of this fact leads to the speculative enthusiasm that inspires some of the current plant expansion. These prospects are so full of hope for high employment and an ever-rising scale of living that it would be a pity indeed if they were to be lost through failure to grapple with the immediate problems. These problems stem from the fact that currently aggregate demand is in excess of supply. Prices are being pushed upward, the economy endangered by cost squeezes, and values inflated by speculation. Too often binges have led to painful hangovers.

At a time when the general business climate is inflationary, it is obviously necessary to pursue credit policies designed to restrain excessive credit expansion. Also it is obviously not feasible for commercial banks to provide for the accommodation of all who wish to borrow. Some loan applications must necessarily be refused or deferred by commercial banks, even though they may be technically credit-worthy.

The recent rise in interest rates, including Federal Reserve bank discount rates, seems to have caused considerable apprehension lest the supply of funds in the money market during the ensuing months be insufficient to provide for essential credit needs, such as the movement of crops and the financial requirements of the Federal Treasury. In view of this apparent concern, it seems desirable to re-emphasize that the Federal Reserve System



has no intention of allowing such a situation to develop. The Federal Reserve System has the continuing duty of providing a monetary expansion consistent with orderly growth of the economy. The discount facilities of the Federal Reserve banks continue to be available to member banks requiring temporary funds for their essential needs.

The goal of economic progress is more jobs and more goods combined with a dollar of stable buying power. The road toward this goal stretches ahead as an inviting path for us and our children provided the current economic traffic does not become snarled. Into the road there is now pouring more economic traffic than the present road capacity will permit to move forward at one time. This traffic comes both from government and from private sources; from corporations anxious to expand, and from individuals who wish homes and other durable goods. Too many people wish to get through first even if they disregard the rules of the road.

What is the nature of this traffic jam that threatens to impede economic progress? The demand for scarce goods is exceeding the supply and pushing prices upward. This explains what has been happening with respect to wholesale and consumer prices. Too many people want too many things too fast. They want to build new plants, office buildings, ships and planes at an unheard-of rate and still retain record rates of production for residences and autos. The resultant pyramiding of demand not only creates scarcities such as that for steel and cement, but for certain labor skills as well.

What is so clearly evident in the case of scarce materials and labor applies also to money and credit. The so-called tightness of credit is often attributed to insufficient supply, whereas it has in fact resulted

chiefly from a pyramiding of demand. Actually the supply of money and credit is larger than a year ago, instead of being smaller as many imply when they use the phrase "tight money."

Moreover, money is being made to work harder. Demand deposits are being turned over about 8 per cent faster than a year ago. This increase in money activity is to be expected in a period of credit stringency, and has the effect of making the supply of money more efficient.

The aggregate and rival demands of corporations and individuals to borrow heavily in order to buy more goods than exist at the moment explain the concern over the cost and availability of credit. When the demand for credit exceeds the supply of it, the price tends to rise. This is how the marketplace allocates the existing supply of credit among the rival claimants for it. In the process, many individuals and companies are disappointed that they cannot secure the funds to buy what they want right away. As a nation we are trying to spend faster than we save. If we should succeed, the higher prices that would result spell inflation with all its dread consequences to savings and to those dependent upon them. The well being is involved of wage earners who have pension rights and similar fringe benefits as well as that of widows, school teachers and all whose incomes are fixed.

There are some who would curb spending through price controls and rationing. Such direct or selective controls over imports, food, critical materials and credit were resorted to by many nations, including our own, during and immediately after the war. It is my conviction that they are only a partial answer. Even supported by wartime patriotism, their success was limited and in the end did not prevent inflation. They did not prevent

eventual loss in the purchasing power of the monetary unit. And they did involve the policing of hundreds of thousands of industrial and commercial enterprises and of private citizens. It is little wonder, therefore, that country after country shook off this harness of governmental controls when peacetime conditions permitted free markets to operate because such markets enable individuals to determine for themselves what they need, what they will buy, and at what price. Even though many individual spending decisions be unwise, the free market gives people the satisfaction of using their own knowledge, judgment, and initiative. In a democratic free-enterprise economy we must depend upon free markets and upon intelligent, not irrational, decisions on the part of businessmen and consumers.

The proper role of government in these matters is to be responsible for fiscal policy, including the balancing of its own budget, and for general monetary policy. Responsible for the fiscal policy are the Treasury and the Congress. Responsibility for monetary policy has been assigned by the Congress to the Federal Reserve System with a mandate to serve as a trustee over the total supply of money and to carry on its work without fear or favor, free from partisan political pressure on the one hand, or private business pressure on the other. Its particular role is to regulate the reserves available to the commercial banks so that bank credit may expand and contract flexibly in accordance with the fluctuating needs of the economy. In the light of the Employment Act of 1946, those needs may be expressed most simply as the fostering of sustained economic growth and the maintenance of economic equilibrium. There can be no economic equilibrium without stable buying power of the dollar.

If the supply of credit becomes excessive in relation to the goods and services available, prices tend to rise; if the converse is true, prices

tend to fall. Therefore, if the value of money is to be stable and to assist the economy to move steadily upward, its supply (at the current rate of deposit turnover) must be harmonized with the flow of goods. Hence, the supervision of government is needed over the total supply of money and credit. The apportionment among individual borrowers, however, is best left to competition between private borrowers and private lenders. It is the responsibility of the central bank to influence the total supply of credit but the selection of the particular customers to whom loans are to be made is left to the discretion of commercial bankers and other private lenders.

#### The Rules of the Economic Road

The problem, then, is to keep the economy running at high speed without overstraining its capacity. A continuous stream of transactions must be kept running much like the stream of traffic on a crowded highway. The latter can move with speed and safety only if drivers observe the traffic rules brought forth by experience.

The rules of the economic road, like traffic rules, are sometimes ignored. Perhaps the most fundamental of them is the preservation of balance and proportion between protection and risk, caution and daring, liquidity and expansion. Moreover, the quality of debt should not be impaired by equity that is overly thin. Finally, the decision-making of lenders and borrowers, whether business executives or consumers, must be prudent to provide economic growth free from serious inflation or from recession with its destruction of values.

The financial panic of 1907 that led to the founding of the Federal Reserve System six years later, the inventory panic of 1920 and 1921 with its crashing prices, and the collapsing stock market of 1929 and 1930 all preach

their respective sermons. The quality of past business decisions may be said to determine the fundamental soundness of the economy at any given time. The decisions of 1955 are reflected in the sales, inventory, and employment figures of 1956 and may indeed influence those of 1957. These business decisions not only are influenced by group psychology; they help to create it. Sometimes they reflect excessive pessimism; sometimes speculative optimism.

One lesson of the depression of the 1930's would seem to be that if equity values suffer from too great destruction, those executives who must venture if the economy is to revive are too distraught and fearful to do so; or if they have the requisite courage and daring, they may no longer be considered credit-worthy by lenders.

In contrast is the psychology of ebullience and of unwarranted optimism. Financial history records boom after boom that burst because men "chased the fast buck" at the sacrifice of prudence. Two observations may be in order. One is that speculative fever may not, if it should again sicken the economy, take the form of stock market speculation like that of 1929 when margin requirements were too low and the rewards of the call-money market were too enticing. Speculation has many forms of dress and even of disguise. The second observation is that neither monetary control nor fiscal policy, nor the two in concert, are likely to maintain economic stability if group psychology runs rampant. How could they revive business from depression in the face of general despair? Or prevent inflation amidst a wave of reckless business decisions?

The problem of protecting the purchasing power of the dollar is like a three-legged stool. It requires the combined action of general monetary policy, of fiscal policy, and of prudent decision making by labor leaders,

business executives and consumers. It would be highly desirable for each businessman and consumer to regard himself as a trustee of the economic health of the whole community. A philosophy of trusteeship and a sense of responsibility are salient features of democratic free enterprise and of a healthy economy.