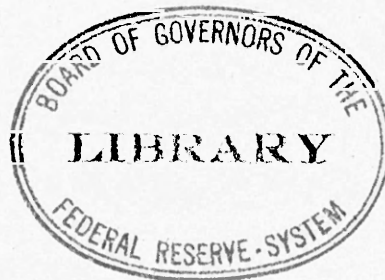


For release upon delivery.



THE VOLUNTARY CREDIT RESTRAINT PROGRAM

An Address by Oliver S. Powell, Member,  
Board of Governors of the Federal Reserve System,  
Before the Annual Convention of the United States Savings and Loan League,  
Municipal Auditorium, Miami Beach, Florida.

Tuesday, November 13, 1951.

## THE VOLUNTARY CREDIT RESTRAINT PROGRAM

When your national officers requested me to come down to Miami Beach to talk about the Voluntary Credit Restraint Program before this great audience, I eagerly accepted the invitation. First of all, it affords a splendid opportunity to explain the Program to this important branch of finance, and second, I want to thank you collectively for the whole-hearted support which I am told that you are giving to the Program.

The title of this talk might have been labeled, "Learning to Live with National Defense". Outside of actual war-time conditions, the United States for generations has found it possible almost to forget defense against outside enemies and to devote its energies completely to developing a higher standard of living at home. Now we find ourselves the most powerful non-communist country in the World, able to depend on other countries for protection only in very limited ways and faced with the problem of rebuilding a strong national defense.

The problem resolves itself into one of increasing the production of defense items while maintaining the supply of civilian goods at as high a level as possible. If the total demand for goods exceeds the supply, prices go up. This is inflation. It hurts the civilian economy and increases the cost of the defense program.

You will recall the panicky buying that followed the Korean invasion. Remembering the shortages that developed during World War II, we rushed to the stores and bought abnormal quantities of merchandise--everything from sheets and coffee to television sets and autos. As you well know, there was also an unprecedented increase in residential building.

This buying rush caused retailers and manufacturers to step up their inventory purchases and production rates, and there was a sharp increase in employment. The inevitable result of all this was a sharp rise in prices, and another round of wage increases.

It is important to analyze the sources of buying power which made possible this abnormal buying movement which was superimposed on a high level of peacetime trade. There were three principal sources of buying power:

First, current income: The sum total of wages, rents and income from invested capital which normally just about equals the production of goods and services at stable price levels.

Second, the use of savings by drawing down savings accounts, cashing savings bonds and spending funds which had remained idle in checking accounts awaiting a suitable time for use.

Third, borrowing against future income: Consumers' borrowings to buy automobiles, household appliances and houses; business firms' borrowings to increase inventories or to pay higher prices for inventories or to extend credit to consumers, or to expand plants.

The combination of these three sources of buying power, when used to purchase a quantity of goods and services that could not expand with equal rapidity, caused a sharp price rise.

The monetary authorities made important moves in their field of action to counteract these inflationary forces.

(1) In August 1950, the discount rates of the Federal Reserve Banks were raised somewhat and short-term money rates were allowed to rise.



(2) The consumer credit regulation was reestablished. The reestablishment of this regulation has not brought about any drastic reduction in the total of consumer credit outstanding. Although the total has declined by \$800 million since last December, the amount of consumer credit outstanding on September 30, 1951 was still \$19 billion. It rose \$171 million in August and \$94 million in September after Congress eased the restraints.

(3) A new regulation dealing with real estate credit was imposed. It is still impossible to appraise the restraining effect of Regulation X since builders are working on the backlog of orders received before Regulation X was announced, and on public housing projects as well as on private construction under the regulation. Moreover, Congress liberalized the terms in August.

(4) In January 1951, reserve requirements of member banks were raised to substantially their upper legal limits.

One of the most important tools of inflation restraint was practically out of use for this purpose for several years. This was the employment of open market operations, which were devoted almost solely for several years to maintaining a pegged price for long-term Government securities. However, the recent reduction in prices of long-term Government bonds has had far-reaching effects in the control of inflation. Holders of those securities have been reluctant to dump them on the market and as a result supplies of funds for mortgage loans and for many other types of credit have been reduced.

The credit policies of the Federal Reserve System have been reinforced by a Program of Voluntary Credit Restraint among private lenders. The general credit policy of the System is intended to reduce the availability of credit in the aggregate and to make it unnecessary for the System to add to bank reserves by the continued purchase of Government securities; the selective credit controls are designed to restrain the extension of credit in a few lines where standard lending practices prevail. Reliance has been placed upon the voluntary credit restraint effort to foster a spirit of caution and restraint in lending policies in general, but especially in credit fields not suited to selective credit controls, and equally to assist in channeling the reduced supply of credit into the defense program and essential civilian activities, while at the same time restraining the use of credit for nonessential purposes.

This Program was inaugurated under the provisions of Section 708 of the Defense Production Act. The authority to set up the Program was delegated to the Federal Reserve Board, which requested a group of financial leaders to draw up a statement of principles and procedures for the voluntary program.

We have now come to the principal part of my talk--the credit standards appropriate for an inflationary period. The first statement of such standards appeared in the Statement of Principles to which I have referred. Credit men in all branches of finance were asked to screen their loans not only as to credit-worthiness but as to consistency with our national efforts to contain the inflationary pressures. Listen to these sentences from the Statement of Principles:

"It shall be the purpose of financing institutions to extend credit in such a way as to help maintain and increase the strength of the domestic economy through the restraint of inflationary tendencies and at the same time to help finance the defense program and the essential needs of agriculture, industry and commerce."

The Voluntary Program does not attempt to override the Federal agencies in the field of inflation control. It does not have to do with such factors as inflationary lending by Federal agencies, which the Statement of Principles states "should be vigorously dealt with at the proper places." Neither does the Program "seek to restrict loans guaranteed or insured, or authorized as to purpose by a Government agency, on the theory that they should be restricted in accordance with national policy, at the source of guaranty or authorization".

The first step in putting the Program into action was for the Federal Reserve Board to request all lenders in the United States to take part in the Voluntary Program. For this purpose a letter was sent to some 90,000 lenders, the broadest list available to the Federal Reserve Banks. Thus, the members of this League are in the Program to the fullest extent dictated by your good judgment.

The next step was the appointment of a national Committee by the Federal Reserve Board. This Committee is composed of men chosen from the principal kinds of lending institutions, with a Federal Reserve Board Member as Chairman. The national Committee has set up regional committees to deal with problems in five major lending fields: commercial banking, life insurance, investment banking, savings banking, and the savings and loan system.



The savings and loan industry has two stalwart representatives on the national Committee: Mike Murphy of Rutherford, New Jersey, and Dr. Walker of Miami, Florida. There are also twelve regional committees, one in each Federal Reserve District, composed of leading savings and loan executives from institutions of varying sizes. Their headquarters are in Federal Reserve cities rather than in home loan bank cities in order to take advantage of the clerical and other assistance which can be provided by the Federal Reserve Banks. These regional committees are set up to answer your questions if loans are presented to you about whose propriety under today's inflationary pressures you are in doubt. There are inquiry forms which you may obtain and which will enable you to submit full information about the problem case so that a prompt and informed opinion can be rendered by the committee.

Right from the start the national Committee recognized the need for direct contact with lenders to explain the Program, to answer the most pressing questions without delay, and to insure uniform interpretation throughout the nation. The national Committee has issued a series of bulletins to all lenders on credit problems in relation to the Voluntary Credit Restraint Program.

You are especially interested in the recommendations of the national Committee regarding loans on residential real estate, particularly one to four family units. Very careful study preceded the issuance of these recommendations. In the early weeks of the Program it was not thought necessary to provide any guidance to lenders in the real estate credit fields not already covered by Regulation X. However, reports were received from all

over the United States of a sharp increase in prices of existing residential property. This seemed an inflationary development in the residential field which should be called to the attention of lenders. At the same time, as stated in the national bulletin:

"The Committee conceives that it is not the function of the Voluntary Credit Restraint Program to make the transfer of real estate impossible or impracticable, but rather to reduce inflationary pressures by limiting the amount of additional credit created in the process of real estate transfer."

Accordingly, the national Committee has recommended maximum credit limits on residential loans on existing property sufficiently below the maximum limits of many types of lending institutions to discourage shoestring purchases. On the other hand, the loan limits are intended to be sufficiently high to permit the home buyer who has a reasonable nest egg of savings to make a purchase. As presently stated, the total amount of credit outstanding with respect to the property or with respect to the transaction should not exceed  $66\frac{2}{3}$  per cent of the fair value of the property, or the limits which Regulation X would impose in the case of loans on new construction, whichever of such limits is the greater. You will note that the recommendation refers to the total amount of credit outstanding, including both the amount loaned by your association and any junior credit which may be involved. The real estate loan bulletin also gives recommendations for limits on other kinds of real estate loans and certain other information which is too detailed for this address. Copies of this bulletin, called "Bulletin No. 4", can be obtained from any Federal Reserve Bank or from the Regional Savings and Loan Committee in your District.



Perhaps the most significant and abiding contribution of the Voluntary Credit Restraint Program is that it has given lending officers new benchmarks for use in their appraisal of loan applications. It has broadened their horizon beyond the fairly limited objective of appraising the credit-worthiness of a prospective borrower. The Program has made them increasingly aware of the importance of credit policy in an economic stabilization program, and it has contributed to prudence in lending. Equally important, these have been achieved without shutting off the supply of credit to borrowers with needs in accord with today's part-defense, part-peacetime economy, and without imposing upon lending operations a burdensome harness of detailed and specific rules and regulations. This has helped keep to a minimum the injustices and inequities which are inescapable under a set of detailed rules and regulations, no matter how carefully drawn, and has preserved the flexibility of movement required by financial institutions if they are to serve the needs of the economy.

Returning now to the over-all national picture, the threat of inflation has not been removed, although it is not possible to predict when the next upsurge in inflationary pressures will occur or what proportions it may assume. Business inventories are at peak levels and the pressure to reduce them still continues. When these inventories stop rising the effect will be to reduce the spending stream. In other words that development would wipe out one of the most important inflationary factors which has been in the picture since the Korean incident in June 1950. The productive capacity of the country is tremendous and the record levels of plant and equipment spending are augmenting that capacity month by month bringing us closer to an ability to satisfy all demands.

Nevertheless, it is not clear that production can be increased sufficiently fast to cover the increased takings for military equipment that are in prospect, without some reduction in supplies available for the civilian market. It is significant that steel output is already 2 per cent above rated capacity and unemployment is the lowest since World War II. Defense spending is rising rapidly and a growing percentage of our defense outlays is going into "hard" goods for which basic materials are short. This rise in defense spending, with unemployment at very low levels, poses the prospect of continuing upward pressures on wage rates and increases in personal income. Business spending for plant and equipment, at record levels, may remain high for some time to come.

The consumer also remains a big unknown in the outlook. Following the two "scare" buying waves of mid-1950 and early 1951, consumers reduced their spending and increased their savings substantially in the second and third quarters of this year. Currently, consumers are spending a significantly smaller portion of their income than was customary in the postwar years. But it is not certain how long it will be before money will again start to burn holes in the pockets of consumers. The new tax law will be a restraining influence but only to a limited extent. The large inventories of goods in consumers' hands, resulting from the overbuying during the past year, will gradually disappear. With personal income at record levels, and likely to increase further, and with large holdings of liquid assets widely distributed, the basic ingredients for an upturn in consumer spending are present in the economy. Even without adverse developments on the international

front, consumer spending is likely to increase; given deterioration in the foreign situation, the rise in consumer spending might assume large proportions.

In closing, may I again express the appreciation of the national Committee for the wide-spread adherence voluntarily to the recommended limits on individual loans. The national Committee is also appreciative of the fact that your institutions are depending principally on your own resources for the funds which you are lending. Your borrowings from the Federal Home Loan Banks have been declining in recent months and your borrowings from other institutions continue small. Thus, you are doing your part both to provide essential credit and to avoid over-extension of credit which is so dangerous to the future value of the dollar under today's emergency conditions.