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Address of J. L. Robertson, Member of

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"THE LINK BETWEEN MONETARY POLICY AND INSTALLMENT CREDIT"

Inasmuch as I was privileged to address your conference in 1950, I know that this is primarily a practical meeting, by and for practical bankers, to analyze the ideas - both proved ideas and tentative ideas - of some of the most capable men in your field. This is exactly as it should be. No one can run a serviceable and profitable consumer installment credit operation on theories alone, no matter how profound. The stupendous American economy is founded, of course, on theories about mass markets, rewards for initiative, and other eternal verities, but it operates - the wheels actually turn - on the lubricant of efficient methods, proved and constantly improved.

But despite the necessity for concentrated attention, day by day, on the basic practicalities, one should never lose touch with the principles on which rest the institution of installment credit, and its relationship to other phases of the American economy, and particularly to the underlying forces and the developments that affect monetary and credit conditions - the field in which the Federal Reserve System has its chief responsibility.

During most of the postwar period we have been concerned about a surge of inflationary pressures, sparked by both the tremendously increased takings of goods and services by the Federal Government to support our defense effort and the waves of consumer buying in anticipation of a repetition of wartime shortages. In recent months, however, we have been preoccupied with an opposite set of worries. Our attention has been focused on the problem of readjustment and the achievement of a smooth shift-over from the highly stimulated conditions prevailing in recent years to what we hope will be a period of peaceful growth and stability.

In this period of transition and uncertainty, every one in this field should know the monetary policy of the Federal Reserve System. By now it should be clear that the fundamental and controlling objective of monetary policy is the same regardless of the economic conditions of the moment. The Reserve System seeks continually to make available all the money and credit the economy needs for normal operation and for healthy growth - but not so much as to set the stage for inflation or so little as to induce deflation. The purpose is not to fix interest rates (which in a private enterprise system should be determined by the forces of supply and demand), but rather to see to it that boom-and-bust cycles do not arise from money and credit causes, and to moderate - within the limits of our ability - cyclical movements stemming from other causes. It is our duty to exercise our powers to aid in averting both inflation and deflation, while seeing to it that the economy is furnished with an ample supply of credit, in order to promote high levels of production and employment, and stable prices.

The very nature of our responsibility will call for actions, from time to time, which will be unpopular with some people. Speaking more specifically, actions directed toward general economic stability may sometimes affect adversely - over the short term - the profitability of commercial banking. In times like the present, for example, consideration of "the general welfare" may dictate measures to encourage credit and monetary expansion, with consequent lower interest rates on securities and loans, which in turn may have an immediately adverse effect upon the income of financial institutions - especially those which do not adapt their policies to those measures.

No group of men could have a greater interest than the Federal Reserve Board in the maintenance of a strong and reasonably profitable commercial banking system in the United States. Only if banking is sufficiently profitable to attract adequate capital and the best financial ability, can it meet effectively the credit needs of a growing economy. Despite this special concern for banking, I want to emphasize that our more fundamental concern - and I'm sure you would have it so - is, and must always be, the maintenance of credit and monetary conditions which are most beneficial to the people as a whole, rather than any particular group.

There has been a wide variety of opinions about monetary policy as carried out over the past two years. So much depends on the spot from which one is observing it! If, as a result of the restraint on credit expansion last year, a banker was obliged to reveal to his directors a sizable book-loss in the government bond portfolio, he was probably inclined to say that the Federal Reserve had done "too much too fast". If, as a result of the more recent easier money policy, one found that the yield on investments was so low that his institution was obliged to go out in active search of more loans and investments in order to avoid showing a downward earnings trend, he might be inclined to say that we had done "too little too late" in the earlier period, and that we were now going too far in the opposite direction.

However, with a frank admission of lack of perfection - for the man doesn't live who can determine in advance the precise result of any significant use of the instruments of monetary policy - I submit that during the past two years Federal Reserve policy has contributed to the long-term economic well-being of the nation. In the boom phase of the winter and spring of 1953, credit restraints helped to discourage speculative excesses, to restrain inventory accumulation, to minimize undue expansion in capital goods expenditures, and to encourage saving. Since last summer the maintenance of credit ease has contributed to a cushioning of the readjustment, by helping to encourage the well-sustained activity in business capital outlays, home construction, and State and local government expenditures. Moreover, inventory liquidation has thus far been orderly, with no substantial pressure arising from financing problems. Certainly the danger of a real depression in 1954 would be much greater if the growth of bank credit had not been damped down during 1952 and 1953. And without the injection of bank reserves under our more recent policy of active ease it would be extremely difficult, if not impossible, to maintain an adequate flow of funds into production activities.

Although I do not contend that we have followed a perfectly-charted course, I believe it is fair to say that the Federal Reserve System has been alert to changing economic conditions, and that it has acted with reasonable promptitude. Furthermore, it has come a long way toward re-establishment of a freely functioning money market in which the forces of supply and demand are dominant rather than dominated. This is a far cry from the pegged markets that, however necessary in wartime, are inconsistent with our private enterprise institutions.

It is particularly important that American bankers in the field of installment credit understand Federal Reserve monetary policy and its impact, even though that policy is not the prime determinant of economic conditions, because it is one of the most powerful factors which influence those conditions. As you know, through the use of <u>general</u> instruments of monetary policy (that is, reserve requirements, discount operations, and open market actions), it is possible for the Federal Reserve System to create conditions of ease or tightness in the money market and in the reserve positions of commercial banks. These changes, to be effective, must reach out through the financial structure and affect the cost and availability of credit to ultimate borrowers, whether they be businesses or consumers.

For many years, consumer installment credit has been considered particularly "insensitive" to <u>general</u> credit control measures. During the past two years, however, there has been evidence that general measures of restraint have considerable effect upon this as well as other types of credit. Whether this is true - and the extent to which it is true - should be a matter of great concern to everyone here, because you are the link between monetary policy and installment credit.

In recent months, concern over declines in production and employment has given rise to a rash of economic forecasts. For a while, observers seemed almost unanimous in their prediction of a slight decline in economic activity in the current year. More recently, the range of forecasts has broadened, and we find ourselves with a wide choice, ranging all the way from a further severe decline to a substantial and rapid recovery. There are some who believe we have created excess productive capacity. Perhaps we are producing more of certain things than we really need. My suspicion is that at the moment our most serious surplus is of forecasts, and I do not propose to contribute further to that problem by adding one of my own.

Nevertheless, I predict it is not safe to assume that outstandings of twenty-odd billion dollars are sufficient proof, without more, that the institution of consumer installment credit is invulnerable. We may have moderated the business cycle, but we surely have not eliminated it. If a real depression should come again, there will be some, including highly-respected economists, who will - and not without reason - cast a large part of the blame on the "pro-cyclical" effects of installment credit - the way it expands faster than the economy in good times and contracts faster in bad times, accentuating the boom-and-bust phases of economic cycles.

Therefore, every leader in the installment credit field owes it to himself and to the economy to know concretely and currently the real significance of installment credit in our economic set-up. It is not enough to be vaguely aware that the present American economy is geared to installment purchasing; that development of new industries, and new concerns in existing industries, depends on a level of demand that would not exist without installment credit.

By its very nature, installment credit plays an exceptionally vital role in our economy. Its management and use demand understanding and the exercise of self-discipline to a degree perhaps greater than any other type of lending. It has explosive qualities which must be handled with both courage and caution - and above all with consummate skill - if it is to blast away obstacles in the road to greater prosperity, and not explode at the wrong time and leave a mountain of wrecked wealth and lives to be cleared away and patched up before we can resume the advance.

To put it another way, you have a bear by the tail - a twenty billion dollar one - and if, during inflationary times (that will come again) it isn't kept in hand and tamed by a mixture of your good judgment and actions, and effective response to <u>general</u> credit control instruments, we can be sure that there will be a move to subject it to the permanent confinement of selective controls - a "Regulation W", if you please. And I can assure you that the Reserve Board is no more eager to take up that thankless job again than you are to have it do so.

On the other hand - just to show the kind of a dilemma you are in - it might be even more dangerous to let the bear go into complete hibernation in times like these, notwithstanding the fact that it obviously has used up a lot of energy in the vigorous uphill climb of the past two years. Excessive contraction of installment credit in times like these is at least as dangerous as expansion at an unsustainable rate in boom times.

I am not recommending attempts to maintain record volume through abandonment of sound terms of payment. That I should never favor, either in flush times or poor. Healthy competition among lenders should lead to better, cheaper, and more convenient loans for consumers, not to inadequate down payments and stretched-out schedules. However, we must guard against the worship of safety to such a degree that it degenerates into stultification and paralysis. No one in this field should run the risk of being correctly labeled a "fair weather banker".

As we shift from the extreme conditions of war mobilization to an economy dominated by private wants and competitive market forces, long-run economic growth must stem increasingly from consumer demand. Therefore, the continuing growth of our economy depends largely on the need, the ability, and the willingness of consumers to expand their purchases steadily.

As to need, many of the most pressing postwar needs have been satisfied, but let us not forget - among other things - that four million babies were born last year, and that ten million cars on the road today are at least twelve years old. As to ability, let us remember that although disposable personal income has declined slightly, savings have been growing throughout the period of declining activity, and are now at record levels. As to willingness, it may be that mass psychology can never be accurately determined, even with the benefit of our Consumer Survey - good as it is. Even an electronic brain cannot tell when the "itch" for a new car is going to become unbearable, or when a kitchen will become intolerable without a new gadget. But there can be no doubt that mass psychology can be influenced. And we must not overlook the fact that bankers - being at the center of the vortex of economic life of their communities - exercise a tremendous influence on the economic decisions of businesses and individuals.

Above all, installment lending policies should be built on a solid foundation of factual information and analysis, rather than on rumors or fear. I can amplify this best by telling you the gist of an as-yet-unpublished story written by my friend, Harry Edward Neal. It is only partly apocryphal. A man from Washington entered the only bank in a small midwestern town (not my home town, Broken Bow, Nebraska - we have three banks there) to cash a sizable check. Since he was a stranger, the teller insisted on the initials of the president. Now, the president wasn't going to let such an opportunity slip through his fingers. If this man came from Washington, he certainly must have the inside story. He must know what the future holds. So he offered to cash the check if the stranger would give him the "low-down".

The Washington man played coy - he denied being a prophet, but he did so with a little shrug which belied his disclaimer; and then after the proper amount of coaxing, he said: "This is something I really shouldn't disclose, but if you promise not to tell anyone else, I'll tell you. We are going to have the doggonedest bust you ever saw. It's going to be a stem-winder." And with that his check was cashed and off he went.

As he went out of the bank, in came farmer Jones, who always came in at this time of year and borrowed enough to restock his farm, buy new implements, and so on. But this time the banker said: "I'm sorry, Mr. Jones, I can't let you have $10,000. As a matter of fact, it can't be more than $2,500." And when pressed for a reason - for Jones knew the bank's deposits had tripled in the last decade - the banker said: "If you won't tell a soul I told you, I'll tell you that I know for a fact, although I am not at liberty to disclose the source of my information, that we are gonna have a bust that'll make '33 look like child's play."

Well, farmer Jones went home and talked to Minnie, and they decided they weren't going to get caught this time, so he fired his only hired hand and called up to cancel his order for a new tractor. The dealer was outraged, because the tractor had arrived and was ready for delivery, but Jones wasn't to be moved. However, he finally felt obliged to explain his action by saying: "It's this way, John, I know for a fact - though I can't tell you how - that we're in for a bust. It's going to be worse than anything that's ever happened - a real gully-washer."

And then the chain reaction started. The dealer canceled his orders; he let his salesmen go; their wives canceled orders for new refrigerators and got on the telephone; and before the day was over, everyone in town knew they were headed for trouble - and fast. Within a week that town was experiencing a real depression - and let's not call it by any nicer name. Neither Neal nor I know what would have happened if, at the end of the week, the Washington man's check hadn't "bounced" and established that he was a fourflusher from the outset.

The point I seek to emphasize is the importance of discounting rumors and thoughtless prognostications. In these days, too many who should know better are prone to believe the forecaster who presents the blackest outlook, to become hysterically frightened and to clamor for help from Washington whenever the upward climb of the economy hesitates or slows down. In such times it is particularly essential that we maintain a firm core of stability - the stability of character and judgment and courage that is even more precious than economic stability. Bankers have a greater obligation than most citizens to resist the temptation to act on the basis of rumors about what "they say" is in the wind.

One of the surest ways I know of keeping one's feet firmly planted and maintaining his balance in the ever-changing, often nerve-wracking, always thought-provoking world of today, is to look at the present in the light of the past. With this in mind, I have endeavored recently to look backward over a period twice the span of my lifetime, and the result has been heartening indeed. During that period, the American people have faced depressions, financial panics, droughts, all the vicissitudes of life known to man, including war and the fear of war - yet, notwithstanding all the individual hardships and disasters, there has been almost steady progress.

But much remains to be done. The very magnitude and complexity of our achievements have brought into being new dangers and new problems. Our present-day economic, social, and political structure is many times more complicated and its difficulties much more intricate than any which ever faced our predecessors; our progress in these fields simply has not matched our accomplishment in physical science and physical production. It is far more difficult than ever before to plan ways and means of solving the myriad enigmas and to maintain the spiritual, moral, and economic strength of our nation. It requires vision and imagination, wisdom and statesmanship. It requires that bankers take their logical place as the leaders of their communities in economic thinking and understanding, and utilize their unique abilities for the welfare of all.

Knowing what Americans have done in the past, we can have confidence in the future, notwithstanding the annoyances of unsolved problems, the gyrations of a swaying economy seeking an elusive stability, and even the buzzings of the gadflies who - for their own self-aggrandizement - would create fear and confusion that divert us from our real work. In the words of Abraham Lincoln at a very much more hectic and foreboding time in our history:

> "The struggle of today is not altogether for today; it is for a vast future also. With a reliance on Providence all the more firm and earnest, let us proceed in the great task which events have devolved upon us."