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POST WAR CREDIT

I was born and raised here. I worked here. From this very hotel I made weekly radio broadcasts on current topics. I like it here. It's always a pleasure to be back.

The war is over and here we are. Here we are--facing a new situation. We've faced so many situations together that this could easily be called just another situation; but this is more than that--at least that's the way it appears to me, at this point of transition from war to peace. It's worldwide, it's complicated, and we are in the forefront. The entire world looks to the United States for leadership. We're a creditor nation, greater than ever before.

And yet--our nation has emerged from the war in better shape than any major nation.

VE-Day and VJ-Day did not permit finance to demobilize. Rather, finance has moved up into the front line of the battle of peace. Our nation, which yesterday was the world's main source of war materials and armed men, is now looked upon as the world's pincipal source of peacetime goods and credit. The difficulties we have already overcome provide assurance that we can cope with those that lie ahead.

No one man saw the entire story of the credit problems of the war, but we in the Federal Reserve System did have close contact with its main theme. The System, as you know, is the central banking agency of the nation, and its broad function is that of contributing its share to the Government's purpose of maintaining economic stability. The Reserve System's part is played by influencing the supply, cost and uses of money and credit. Very early, with the approach of war, it became evident that the System's task, in the event of war, would center upon helping the Treasury to obtain all funds needed for the prosecution of the war and, equally upon stabilizing the market for Government obligations. That the nation was to absorb Government securities in excess of $220 billion on top of an existing national debt of $40 billion could not, of course, be accurately foreseen, but even so early it was evident that the demands upon investment would be vast and beyond all past experience. It was apparent that market fluctuations must not be permitted to interfere with Treasury offerings. But the necessity of supporting Treasury financing was parallel to another responsibility of the Federal Reserve System--that of fighting inflationary developments so far as possible by means at its disposal in the monetary and credit field. A serious inflation would have been vastly disruptive to our war effort. We couldn't afford to permit the value of money to depreciate and thus to weaken the will to save. While it was necessary to maintain credit ease for Treasury financing, it was a policy that could have been carried too far. That is why credit restraints in fields such as consumer credit and stock market credit were made operative.

Before the attack upon Pearl Harbor the Treasury and the System's Open Market Committee decided, in the event we were drawn into the war,

to maintain a structure of yields on Government issues. The rates ranged from 3/8 of 1 per cent on 3-month bills to 2-1/2 per cent on long-term issues. Compared to those of the World War I, these rates were moderate indeed. Also, compared with the first world war, these rates did not increase as the war progressed. In fact, although the two terminal points of the structure of yields were maintained, the yields on medium-term securities are actually lower now than they were at the beginning of the war. The maintenance of such stability in rates may well be regarded as an unexampled feat in the annals of war financing. The principles that were applied were, fundamentally, as simple as they were successful.

First was the principle of buying and selling Treasury issues to steady the market. This was carried out through the open-market operations of the Federal Reserve System. There is no mystery about this: when offerings of Government securities were in excess of demand, so that the rate structure might be inclined to rise, the System bought those issues in the open market in amounts sufficient to balance supply with demand and to neutralize the upward pressure. Conversely, when the demand for individual issues was in excess of supply, so that the rate structure might fall, the System made sufficiently substantial sales of those issues to satisfy the market. I do not wish to give the impression that the application of this policy was as easy as falling off the proverbial log, for decisions have been difficult at times, but the record of results remains.

Second--in order to provide an adequate and continuous market for Treasury offerings, it was necessary that the resources of the commercial banks, which were fortunately at a high level, be released on a gradual basis, as the situation might require. On the day after the Pearl Harbor attack, the Board of Governors issued a statement to the banks calling attention to their plentitude of funds, assuring them that the Federal Reserve System would support them in full in their aid in financing of the war, so far as that aid was required, and specifically stating that the System stood ready to advance funds to banks on Government securities at par. This statement proved effectual. The System backed it up with action. In November 1942 the System, together with the Treasury, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the executive committee of the Association of State Bank Supervisors, issued a statement, assuring banks that the examination and supervisory policy would not deter bank investment in war securities with certain restrictions as to kinds of securities banks can buy; also that these supervisory authorities would not look with disfavor on loans up to 6 months made to the public for the purpose of public buying of Government securities.

However, the stabilization problem became not only one of sufficient credit ease but also one of excessive ease. So rapidly were funds supplied to the Treasury and so rapidly did these funds begin to pervade the productive economy, through increases in dollars in circulation and increases in bank deposits resulting from purchases of Treasury offerings by banks, that member banks began to feel the need of replenishment of their reserve position. The increasing demands for bank credit by enterprises producing for war further increased the banks' requirement of reserves. It was a demand which early in 1943 passed the $3 billion mark in loans outstanding, and rose to $3.5 billion by the end of the year.

it was, of course, encouraged by the guaranteeing of war production loans under the Board's Regulation V.

Therefore, this condition called for an approach along several lines. First, the Federal Reserve System so directed its open market operations as to relieve some of the pressure upon bank reserves; but, mind you, not to release large and unnecessary amounts of excess reserves, but small and necessary amounts as needed. Next, the reserve requirements for central reserve city banks (New York and Chicago) were reduced from 26 to 20 per cent. Borrowing by banks from Federal Reserve Banks, which had been largely a discontinued practice in the period when excess reserves were abundant, was encouraged through establishment by the System of low discount rates. Reserve Bank loans to member banks reached the highest levels in both number and amount for many years.

The System in addition established the policy of buying Treasury bills from banks, under an option by which banks could repurchase them, at 3/8 of 1 per cent. Also, Congress suspended reserve requirements against war loan deposits for the period of the war. However, the System's policy was influenced by the general objective of selling as large amounts of Government securities as possible to buyers other than banks; a policy that not only greatly helped to ease the pressure upon bank reserves but also absorbed idle funds that, otherwise, might have been used to bid up prices to create uncontrollable inflation. Not only did the Federal Reserve in its operations follow this guiding policy, but it gave counsel to the Treasury and to the banks on this vital matter, in pursuance of this policy.

By means of these various actions, and of others that were taken from time to time as the situation required, the largest scale financing in history was accomplished without swamping the investment market or undermining the dollar on which the entire operation was based. We inherit in this period of reconversion a credit responsibility carried over from the war, and this is it.

I need not tell you that, because of the success in marketing and maintaining the market for Government obligations, this type of investment is today of underlying importance in the financial structure of banks, insurance companies, savings banks, and institutional investors of every type; of business corporations large and small, of the very numerous unincorporated businesses, and of countless individual investors like ourselves. I need not point out that the value of this all-pervading investment would be affected by inflation.

Of all our responsibilities, it seems to me, perhaps the greatest continuing responsibility is that of protecting our common investment from a decline in its value; which is only another way of saying that we must do our utmost to prevent inflation. We must protect our investment in the victory that has been won.

Because I wanted its connection to this most fundamental of all problems to be clear, I have omitted until now my mention of one aspect of Federal Reserve policy that most nearly concerns you. I spoke of the abundance of purchasing power in consumer hands, and the capacity of that buying power, if not applied to aiding the war effort, to go in the

other direction, to burst the price ceilings, and, by reducing the worth of the dollar, to operate to the detriment of the entire financing of the war. This danger was especially serious because liquid funds in the form of currency and bank deposits have been and are at an unprecedented high level. Dollar circulation increased to $27,804,000,000 on September 30, 1945, and demand deposits of individuals, partnerships, and corporations in insured banks rose from $36.5 billion at the end of 1941 to more than $64 billion at the end of 1944.

Many consumer goods have been and still are in short supply. Obviously the danger of inflation from this cause still exists.

The classic effect exerted by inflation through a high cash buying power against a short supply was subject to restraint by price ceilings, These were established, but the pressure against them was heavy, and it was clear that the additional buying power which consumer credit could supply could easily, added to the cash pressure, be the marginal factor, however small, that could burst the ceilings and with them the war investment market. In 1941 the President of the United States took cognizance of this possibility and by Executive Order No. 8843 enjoined the Federal Reserve System to take action to discourage consumer credit. The Board of Governors in response to that order issued Regulation W. You are familiar with the terms of that Regulation, and I need not recount them, except to call attention to the temperate language used by the President in his message to Congress bearing upon the order, an attitude that was reflected in the Regulation itself:

> "To keep the cost of living from spiralling upward, we must discourage credit and installment buying, and encourage the paying off of debts, mortgages and other obligations; for this promotes savings, retards excessive buying and adds to the amount available to the creditors for the purchase of War Bonds."

The order, unprecedented as it was in this country, met with immediate response. Financing institutions at the time, 1941, were at their all-time peak of consumer credit, especially installment financing. Those institutions that were directly engaged in financing of consumers might be conceived of as having two conflicting points of view, their immediate interests appearing to run counter to their long-time interest; their daily business to pull in one direction, their stake in the war effort in another. If such were the case, then the record shows that they chose the long-time point of view, for the extent to which Regulation W has been self-enforcing on a voluntary basis stands as clear evidence that those men most interested in the financing of buying power were willing to help fight inflation at the cost of reduced business to themselves.

Now, the record further shows, first, that the fight against inflation, while not completely won, has by no means been completely lost; and further, that the commercial banks felt the dislocating effects of Regulation W more than did the small loan companies. I understand that from about 1910, when States began to pass enabling laws, to about 1934, the licensed small-loan companies had this field fairly well to themselves except for some competition by credit

unions, industrial banks and receivable financing companies. About 1934, the commercial banks became active in installment financing, and in the ensuing 7-year period, in which the total volume of installment financing rose from about a half-billion to about 2-1/2 billion outstanding, the small loan companies gained in volume by about 115 per cent, whereas the outstandings of commercial banks rose from less than $50 million to about $780 million, or by a much greater percentage. However, the total volume of outstandings declined by about 50 per cent from 1941 to the early part of 1944. This was due to various factors: The shortage of consumer durable goods resulted naturally in a limited volume of new business, and Regulation W tended to expedite the repayment of debts incurred. Naturally those parts of the consumer credit business that were the most intimately tied to the market for consumer durable goods suffered the greatest losses in volume. The discounting of sales contracts for automobiles and similar goods declined more than four-fifths and this effect was felt most keenly by sales finance companies and banks. Cash installment loans were somewhat less severely curtailed. Such loans at commercial banks declined by almost one-half from the peak of 1941, by about two-fifths at credit unions and industrial banks, and by about one-third at small loan companies. For more than a year now there has been relatively little change in consumer credit volumes; such change as has taken place has been mainly a slight increase.

I need not here discuss action taken by our Board to restrain uses of stock market credit. May it suffice to say that the present cash requirements are 75 per cent.

And so we come to the situation as it is today.

There is much complexity and there are many contradictions in our present situation; yet I feel sure there is a virtually universal recognition of the fact that increased production, the greatest abundance of production we can get and at the earliest date, is the primary key to those problems that present themselves as the most serious to finance.

On the one hand: The Office of War Mobilization and Reconversion, in its report to the President on October first of this year, states that

> "By next spring with demobilization running at better than a million a month, unemployment may rise to about 8 million. The total will depend on how fast reconversion and expansion can be accomplished."

And again, in that same report, Mr. Snyder, Director of Reconversion, speaking of our vast purchasing power and stifled war-time demands, says

> "Big as the backlog is, our economy cannot carry on out of accumulated savings alone. These savings are largely in the hands of middle and higher income groups. There are millions of families with little or no savings. The steady market that business and agriculture need, to reach full employment, must come chiefly from current wages and salaries."

Shrinkage of current income, of course, is a deflationary element in our economic picture. There are also other contributing deflationary features in the present situation which we need not detail now.

On the other hand: We do not need theory to recognize that, in maintaining the stability in a free economy, a normal balance between the supply of goods and the demand for goods is the main necessity. If the supply-demand equation is over-balanced on the supply side, prices drop; if the equation is over-balanced on the demand side, prices rise.

At the immediate moment, production is far in arrears; demand for goods is enormous and urgent. There is a psychology that tells us that the war is over, that we can put the rifle in the corner and go home, relax and enjoy life in its fullness. Yet we need hardly to be told that the poorest service we could render to our economy would be to let the forces of a pent-up domestic and world demand be unleashed upon that economy, without restraint and without safeguards to prevent these forces from having an inflationary instead of a constructive and stabilizing influence.

The present unbalanced situation, we know, is temporary. In some consumer lines, alleviation of shortages already appears. There is world shortage of supply in lumber, paper and pulp, rubber, cotton and woolen textiles, sugar, fats and oils, brick, lead, tin and other basic commodities. Some of these shortages will be overcome sooner than others; all will ultimately be overcome. There is a bright side of the picture, too, in the fact that, generally speaking, American productive enterprise is well equipped with funds for the internal financing of its reconversions, and in the fact that planning for individual reconversions is in many cases complete. But we also know that the manufacture of new machinery takes time, labor-management adjustments take time, proper tax adjustments take time, and until a consistent flow of needed raw materials and parts is assured, the mass-producing industries, especially, cannot start their assembly lines. Some industries are beginning to revive and replenish the inventory shelves already, others will do so with a considerable lag; it is a process of step-by-step reconversion, paralleling the uneven previous process of conversion to war.

Looking at the demand side again, which remains the dangerous side until shortages are removed, we see not only the deferred domestic demand, of which various high estimates have been made, but also the demand of the devastated and impoverished foreign countries, as to which no reliable estimate exists. Both demands will draw heavily upon the producing capacity of the United States; the domestic demand because it is here already, and the foreign demand because governments, relief agencies and individual businesses in foreign countries must have goods of every type, and we are the best potential source of what they need. We want to meet that foreign demand, not only for the sake of the trade and an expanded business activity at home or because of the friendly international relations and a sense of moral obligation to share with those who deserve our gratitude, but also because the prosperity of our international environment directly affects our own prosperity and our own economic stability at a high level. The new international structures, proper policies of our Export-Import Bank operations and other Government lending and sound judgment in private lending and business investment

abroad can and doubtless will spread the impact of the foreign demand upon our markets; international loans made and under consideration will gradually revive foreign production and aid in establishing a balanced world economy essential to world stability; there is a good prospect that the international effort to stabilize foreign currencies in terms of our own will not be frustrated by the kind of price-bidding that causes inflation in the world as at home. But here again we seek balance--balance of international payments. International credits, unlike domestic credits, involve transfers from one currency to another, and these transfers can be made only if merchandise exports and imports, together with other international transactions, are all in balance. The difficulties of making international transfers--particularly if major trade barriers must be hurdled--have been much in our minds. It is a complex question of great concern to our economy. Much can and doubtless will be said about it, but this is not the time.

What we ourselves must concentrate upon in our domestic program is the maximum acceleration of production; and until inventories are also in balance, we must concentrate upon the maximum possible prevention of inflationary purchasing, here at home.

In the encouragement of industry to speed production, various actions have been taken by Government. The Board of Governors has taken two actions which reflect the policy of balancing the supply-demand equation as soon as possible by the use of credit. While, generally speaking, our productive enterprise is well equipped with funds, there are and will be many exceptions in the reconversion of small business, depending on kind and size of enterprise as well as type of reconversion. More than a year ago, therefore, in conformity with the forward-looking recommendations of the Baruch-Hancock Report, the Board asked Congress to amplify the powers of the Reserve Banks, under Section 13b of the Federal Reserve Act, to underwrite the loan risks of commercial banks and other private lending institutions in providing funds to business and industry for reconversion purposes. The form of underwriting that is proposed is the same that has been tested by experience during the war under Regulation V, in guaranteeing some $10.4 billion of credit authorizations for war production, and in fact was well tested prior to the war by Federal Reserve Banks in guaranteeing bank loans under the commitment provisions of the existing Section 13b. The guarantee is simply a "take-out agreement", by which a Federal Reserve Bank contracts with the lending institution, in advance of each loan, to buy a participation up to a stipulated percentage of the loan at any future time, on demand of the lending institution. For this assurance that it can in the future rid itself of part of a transaction, should loss be threatened or occur, the commercial lender pays a portion of its return on the transaction as a fee. The result is a net return, for the guaranteed loan generally represents new business--typically, a technically troublesome loan, or one in which the security is somewhat inadequate--which otherwise would have to be declined. The proposed guarantee plan may apply to any type, purpose or term of business loan, and any type of lending institution may use it. In practice, it appears that the plan will most greatly aid the smaller businesses, whose ability to supply loan collateral in proportion to their credit needs is often deficient. Congress to date has not adopted this measure, known as the Wagner-Spence bill (S. 511 and H.R. 591); the measure which by its terms is intended only for the transition period, is before the Banking and Currency Committees of the House and Senate, and

I commend it to your attention because it is a constructive measure that would strengthen the national economy and thereby be of indirect benefit to small loan companies. It is a well-known fact that your business expands as the national economy expands.

The second action taken by the Board of Governors is more familiar to you, and indeed I understand that there has been some disappointment in this connection. In its desire to release credit as soon as possible for purposes of production and employment, the Board on September 25, by an order effective October 15, adjusted Regulation W by exempting credits for home repairs and improvements (for which a great social need exists), and by lengthening from 12 to 18 months the maturity limit on loans which are not for the purpose of purchasing consumers' durable goods. Production thus gets the green light, whereas, for reasons that I have tried to explain, loans for financing the purchase of consumers' durable goods listed in Regulation W still remain under their former degree of partial restriction. To emphasize the temporary nature of the present situation, let me recall to you the language used by the Board in making this initial relaxation:

> "Until consumers goods come on the market in sufficient supply to meet demands, the Board believes that the use of consumer credit should be discouraged. Accordingly, the Board, after reviewing Regulation W now that the war has ended, has concluded that the Regulation should not be substantially amended at the present time except in the two particulars specified."

It is my understanding that you would like to have the latest amendment to Regulation W clarified in its application to outstanding nonpurpose loans made before October 15. It is also my understanding that you would like to have the regulation contain more explicit and more liberal provisions respecting consolidations, or what you call "new loans to present borrowers". Both of these matters are now being worked on by the Board and the Federal Reserve Banks and you may be sure that, among others, representatives of the small loan companies are being and will be consulted with respect to any amendment that may be proposed.

It is indeed a matter of timing, and timing is of the essence of the problems of credit that now exist. Timing of supply so that it increases with the utmost rapidity in each given line, timing of demand so that it does not prematurely swamp supply and postpone the day when the supply-demand equation is generally balanced. We know our amazing productive capacity, and we know that the demands of a devastated and goods-hundry world assure that capacity of abundant markets for a long time to come. What we cannot be so sure of is that mistakes in details may not be made; that the impatience that everyone feels to confide the credit task to the free forces of a free economy may not result in premature action at times. I am not a prophet but, for what my forecast is worth, it is that as the restoration of production goes forward and the national peacetime economy expands, the total volume of consumer credit will increase again and in a few years will be vast, to say the least, by any comparison. We hope the expansion will be orderly, will not lead to excessive demands for goods, and will not be followed by severe liquidation. Having thus far held the line against inflation, not perfectly, but with a remarkable degree of success in view of the

economic pressure thus far, we have no reasons for lack of confidence that, with a more widespread understanding of how fundamental the value of the dollar is to this nation and to the world, those who are on the firing-line of the credit problem will obtain the necessary cooperation.

To summarize: The war is over. We won. Free enterprise is once again on trial and credit is the blood and sinew of free enterprise.

Will private credit meet the test by adjusting operations in the transition period to the sound economic requirements of short and long-term reconversion of our country? In a world torn asunder by a total war that has not only wrought destruction to property and manpower but has changed the face of the earth economically as well as socially and politically, this will not be easy. It will really take more than understanding; it will take bulldog tenacity and infinite patience. As private lending meets the test, however, it will help not only to establish a sound peace but it will help assure the maintenance of our economic system.

The Federal Reserve is aware of its responsibilities in the monetary and credit field during the transition.

The situation is full of contradictions, but as these did not deter us from winning the war together so they will not deter us from winning the peace together and, God willing, we shall have peace!