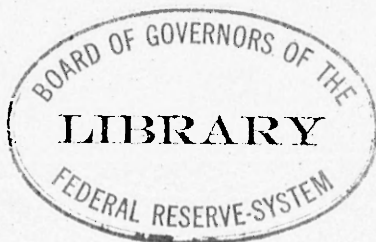

REMARKS

by

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Member, Board of Governors of the
Federal Reserve System,
Washington, D. C.

before the

Twentieth Annual Stockholders' Meeting,
Federal Home Loan Bank of Chicago

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THE RESPONSIBILITIES OF PROGRESS

This twentieth annual meeting of the stockholders of the Home Loan Bank of Chicago marks an important milestone in the history of this Bank. For that reason, it is most appropriate to highlight some of the significant changes which have taken place in your institutions since the inception of the Home Loan Bank System.

Home mortgage lending in this country has always been a predominantly local enterprise based largely on local resources. Despite the fact that mortgage financing during the Twenties had become one of the largest single outlets for investable funds, the thousands of home financing institutions throughout the country were operating without access to the broad capital market. There was great need for a credit reservoir which could be tapped to supplement local sources of money. The Home Loan Bank System was created in 1932 to help meet this need.

Since their creation, the Home Loan Banks have extended nearly 5 billion dollars in long and short term credit to System members. This credit has been extended to balance seasonal fluctuations in the flow of money in and out of member associations, to supplement the local long term resources for mortgage lending, and, occasionally, to meet emergency conditions. You have reason to be proud that the Federal Home Loan Banks have never lost money on any advance to a member institution.

The Home Loan Bank System was created too late to bring much relief to the distressed home-mortgage market of 1932-33, and it is probably fair to say that it has yet to meet the first situation that

would test its maximum capacity. So long as its members have provided adequately for their own liquidity and so long as they have not abused their borrowing privileges in good times such as the present, it is clear that the Home Loan Bank System can -- and does now -- provide a liquidity for mortgage loans that helps to remove one of the most serious weaknesses of the early Thirties.

The savings and loan industry today bears little resemblance to the loosely knit group of small, part-time, neighborhood associations that predominated when the Home Loan Bank System was created a little more than 20 years ago.

Even though your associations still concentrate on local thrift and home financing activities, their combined efforts on a national scale are a major factor in these vital areas of our economy. You can no longer -- if you ever could -- insulate yourselves from the far reaching effects of national economic developments. Indeed, you are an integral part of these up and down movements.

One of the corollaries of progress, of course, is increasing responsibility. Since your operations can make a significant contribution in shaping our economic destinies, the day-to-day decisions each of you makes in your own association will determine whether that contribution will be positive or negative. It is no longer enough for you to be an expert in conditions in your own community. You must not only be competent in terms of your own business, but you must also seek to understand those broader economic forces arising in other areas of activity that are likely to influence your operations.

This same principle applies, of course, with equal force to the management of all financial institutions. Only in this way can the operations of such institutions be guided to make their maximum contribution to stable economic progress. Without such progress, the existence of all free and independent financial institutions -- in fact, of our whole free enterprise system -- would be seriously threatened.

ECONOMIC DEVELOPMENTS

What are some of the more major economic developments which we should know?

First of all, throughout the past seven years we have witnessed a continuation of the rapid expansion in productive capacity that was initially stimulated by the war. Our manufacturing capacity has more than doubled since 1939, and has increased about 50 per cent just since 1945. In terms of physical volume, our present output of industrial production is at the highest levels in our peacetime history.

The total value of all goods and services produced in this country has jumped almost a third since the spring of 1950. About half of this has been growth in physical volume and about half has reflected higher prices.

The past two years have brought a higher level of both defense and civilian output without a further general rise in prices. In raw material markets many prices have returned to pre-Korean levels. Wholesale prices have also declined from their early 1951 peak. The drop in farm prices since last August has brought them to a point

only 5 per cent above their pre-Korean levels. Prices of industrial products, on the other hand, are still about 10 per cent higher than before Korea. They have shown only a 4 per cent decrease from their 1951 peak and none at all since last summer.

Prices at the consumer level, which continued to advance fairly rapidly in 1951, slowed down to a walk last year, registering less than a 1 per cent rise in 1952. Consumer prices have been inching downward thus far in 1953.

One fact brings home very clearly to me the expansion of our economy and the increase in our standard of living during the war and postwar period: Even after adjusting for a much larger tax burden, for substantially higher prices, and for almost 25,000,000 more people, the average per capita disposable income in the United States was one-third larger in 1952 than it was in 1940.

Disposable personal income, after adjustment for price changes, has risen from an annual rate of 222 billion dollars in the months just before the start of the Korean fighting to an annual rate of 242 billion dollars in the fourth quarter last year. Personal saving -- to get closer to your operations -- has averaged more than 15 billion dollars a year from 1950 through 1952, in comparison with a 5 billion dollar average in the 1947-1949 period.

Reflecting high personal incomes, consumer demand for durable goods and housing continues strong. Since June 1950 we have built more than 12 million new automobiles, and current production is at the rate of well over 6 million cars a year. We have sold 18

million television sets not to mention all the deep freezes, refrigerators, washers, dryers, and air conditioning units. New housing starts this year may be about the same as last year, when they were the second largest on record.

Now that defense expenditures are leveling off, it becomes increasingly clear that in many respects we are shifting from a defense-stimulated economy to one based more on civilian demands. In many ways the transition thus far has been highly encouraging. Prices are stable, capacity is almost fully utilized, unemployment is extremely low, and per capita consumption is rising. There has been considerable flexibility in the economy -- more than has been commonly recognized, I think -- with substantial adjustments in production, prices, and wage changes in various sectors.

In other respects, the initial transition has been less satisfactory. Business inventories, already large, have begun to increase again. Inventory accumulation, which was about zero in the first half of 1952 rose to a seasonally adjusted annual rate of 8 billion dollars in the fourth quarter last year. Total book value of manufacturers and trade inventories at the end of 1952 stood at 73.4 billion dollars, which compares with 62.0 billion dollars two years earlier. Although there is no evidence of speculative inventory accumulation, continued high rates of accumulation could be a threat to economic stability.

CREDIT CHANGES

Then there are some aspects of recent credit developments which also are a matter of interest. Greater use of credit has been a major factor in the current expenditures of both consumers and business. Credit demands in 1952 were even larger than in 1951, when they were already at well advanced levels. Corporations, consumers, and State and local governments expanded their borrowing considerably. In the second half of 1952, the Federal Government was also an important borrower.

Consumer instalment credit, which now stands at a record 16.8 billion dollars, has been expanding rapidly since the authority to regulate it expired last year. The 3-1/2 billion dollar rise in this type of debt over the past year reflects both an increased proportion of sales on credit and the effect of lower down payments and longer maturities on instalment contracts.

All of you in the savings and loan industry are well aware of the expansion in mortgage debt that has accompanied the high levels of new home building. Nonfarm home mortgage debt has increased 16 billion dollars since the outbreak of hostilities in Korea to reach its present level in excess of 58 billion dollars. This is more than a 40 per cent rise in less than three years!

I hardly need explain to this audience that on present day long amortization schedules, an owner's equity increases very slowly during the first years of the contract. Many of these loans can hardly be called "seasoned" as yet. Some of those who bought, particularly

at advanced prices, might find themselves overcommitted if there were any sharp declines of incomes and values.

RESTRAINT ON CREDIT EXPANSION

In the light of continuing strong demand for all types of credit, Federal Reserve actions have been designed to prevent an excessive addition to the money supply, to encourage credit restraint, and to allow market forces to operate to bring about more effective use of the economy's real savings.

To a considerable extent the large credit demands in the past two years have been met out of increased savings. Rapid growth in savings deposits, savings and loan shares, insurance and pension reserves, and other savings forms has provided a principal source of new funds.

Of primary importance among the steps which have been taken to restrain credit expansion was the action by the Treasury and the Federal Reserve taken in early 1951 to minimize the conversion of government securities into active money at the will of the holders. With Federal Reserve policy tending to limit the supply of additional credit, banks needing additional reserves to support their deposit expansion had to liquidate assets or to borrow from the Federal Reserve Banks. The granting of discounts and advances by the Federal Reserve to its member banks again became an effective instrument of credit restraint. Because member banks do not enjoy being in debt to the System, this borrowing has always been essentially temporary in character.

With restraint on the supply of credit and a strong continuing demand for its use by various kinds of borrowers, it was inevitable that some credit demands could not be met. There was a general tightening of the money market which was reflected in the last half of 1952 by a firming of interest rates, particularly for short term credit, but there also has been some advance in rates for long term credit as well.

Sometimes it is easy to place so much emphasis on interest rates that we lose sight of the fact that changes in interest rates are essentially only by-products of flexible credit and monetary policies designed to promote economic stability. Putting limitations on credit availability tends to be reflected in a firming of interest rates; an easing of credit tends to soften interest rates. An expanding demand for credit will naturally result in higher interest rates unless additional supplies of funds are made available. The increase in interest rates recently, then, is the direct result of allowing the forces of supply and demand to operate with a minimum of interference in a free money market in which some restraint is appropriate in boom times in order to avoid excessive expansion of the money supply.

Possibly some of you would be interested in more of a discussion of what has been happening in the money market since March 1951 than time permits us here today. May I suggest to those that they write to the Reserve Board for copies of Chairman Martin's recent remarks on the "Transition to Free Markets," delivered before the Economic Club of Detroit. All of you, I think, have a vital interest

in this portion of his remarks:

> "There are still some who would have us return to a pegged market. If we did, we would have no reliable safeguard against the erosion of our savings, our pensions, our life insurance policies -- the capital upon which the institutions of private enterprise rest. There are no reliable substitutes for free markets which have been reinstated during the past two years. A redundant money supply can be dammed up by direct controls for a time, but as we saw in the early postwar years, once the controls are lifted, as the public insists that they be in peacetime, the economy is engulfed with the flood of money that has already been created and only temporarily held back."

The return to a free money market is only one of a number of steps by which we as a nation have placed increasing emphasis on credit, monetary, and fiscal policies for maintaining economic stability.

As I said at the Wisconsin School of Banking in August 1950, just a few weeks after the start of the Korean fighting, development in this direction is particularly appropriate in an era when the world is divided between those who would control virtually every individual decision and those of us who would maximize the area of initiative, individual choice, and a free play of competitive forces within the framework of our democratic institutions.

A WORD ABOUT COMPETITION

Let me digress for just a moment on this subject of competition. As you would surmise, I frequently have the opportunity

of attending meetings of bankers groups, too, and the progress of your institutions often provides a topic of lively conversation. In our free enterprise society, competition is one of those basic elements which helps to keep every business on its toes. As you all know, savings and loan associations have been proving a match for other types of savings media. Your success is now stimulating these other businesses to place renewed emphasis on the promotion of thrift. For the most part this has been friendly, healthy, virile competition; but every now and then the sounds I hear seem more like feudin' and fussin'.

I am encouraged that your leaders and those of your competing businesses are working diligently toward the goal of a common understanding. All of us recognize, I think, that generally speaking financial institutions prosper or suffer alike. We are aware of the fact that the bank on the corner and the savings and loan across the street will both be losers in a running feud; conversely, they will be mutually benefited if they understand and respect each other's objectives. As members of the financial community, we must share this responsibility for reaching a common understanding of objectives and of the role of each institution in meeting the needs of the general public for financial services. A constructive approach to these matters today will avoid headaches and heartaches tomorrow.

TWENTY YEARS OF PROGRESS

Now I should like to review very briefly some of the more significant recent developments in the savings and loan industry. I'm

not going to pretend to be telling you things you don't already know -- and let me make it clear that I have no intentions of infringing on the supervisory responsibilities of the Home Loan Bank System -- but perhaps, as an interested observer, I may be able to put some facts about your operations in a new light.

The development of the savings and loan business during the past two decades has been most impressive -- not only in the region served by the Federal Home Loan Bank of Chicago, but throughout the country. In just one decade, assets of all savings and loan members of the Home Loan Bank System have multiplied more than 4 times, rising from 5 billion dollars to more than 21 billion at present. The growth in Illinois and Wisconsin has been at an even more rapid pace. Assets of member associations in this District have increased roughly 5 times in the last 10 years, from half a billion dollars to approximately 2-1/2 billion dollars.

A more revealing aspect of this growth is seen in the large volume of savings attracted by your institutions. The member associations in Cook County alone now hold savings of well over a billion dollars -- which, incidentally, is equal to about half the total of commercial bank time deposits in this area. In Illinois and Wisconsin, your savings aggregate more than 2 billion dollars.

Along with your tremendous growth, it is well that you have also placed increased emphasis on improving liquidity and strengthening your reserves, for there can be no doubt that the public generally has the impression that funds deposited with your institutions may be withdrawn

virtually on a demand basis. To meet a more rapid turnover of the share accounts resulting from this fact, liquidity positions have been substantially improved. Today the ratio of cash and Government securities to savings for the average association is nearly double its prewar relationship.

An average, however, may be deceptive. It often hides a considerable degree of variation among individual institutions. This was amply demonstrated in some figures recently presented by the General Manager of the Federal Savings and Loan Insurance Corporation for the 50 largest savings and loan associations. It was found that for this group of institutions, the ratio of cash and Governments to savings ranged from a low of 7 per cent to a high of 39 per cent; that 1 in 5 of these associations had liquidity ratios of less than 10 per cent.

A more revealing index of the true liquidity of an association, it was pointed out by Dr. Husband, is found in relating mortgage loans to savings. Such a ratio shows the extent to which funds are committed to long term investment. For these same 50 largest associations, the ratios of mortgage loans to savings accounts ranged from a low of 56 per cent to a high of 150 per cent!

In the matter of increased reserves, in 1942, the member associations of the Chicago Home Loan Bank District had reserves and undivided profits of 37 million dollars. Today these accounts total approximately 172 million dollars -- a fivefold increase in 10 years. Impressive as this has been, the growth in reserves has not

kept pace with the growth in total assets. During the past decade, the reserve ratio for associations in this Home Loan Bank District has dropped from 7.7 per cent to 7.0 per cent.

The data referred to earlier for the 50 largest savings and loan associations in the country show their reserve ratios ranging all the way from a little over 3 per cent to 15 per cent. Nearly a third of this important group had reserve ratios of less than 6 per cent. Probably similar variations exist among the associations in this District.

This wide range of individual differences is extremely important. It indicates that within your own business not all associations appear to be competing on the same basis. It indicates that some institutions may have been able to expand rapidly and at the same time maintain sound operating standards; apparently others have not been so successful. It may even indicate that some institutions have been reaping the benefit which share account insurance offers to attract new savings customers without at the same time providing them the protection of adequate operating standards. If I may quote Dr. Husband again, "We should recognize that insurance can hurt this business if it is allowed to become a cloak for promotion rather than a support for sound management."

CONCLUSION

The old saying that no chain is stronger than its weakest link has particular application to the financial community. We would agree, I think, that financial institutions tend to prosper and suffer alike. Therefore, standards of financial leadership must be in strictest

conformity to sound operating policies. It is not enough that the burden of leadership fall on the shoulders of a few enlightened institutions. Unless the vast majority of financial institutions follow such practices, the strength and soundness of all may be seriously undermined.

Now, as always, there are many uncertainties ahead. Undoubtedly there will be many adjustments to be made in the transition from a defense dominated economy to one based more on normal civilian demands. This is a time to remain calm and to be informed. This is not the time to be either unduly concerned or complacent.

The flexibility which the economy has already demonstrated in the past 2 years provides a basis for cautious optimism. It clearly emphasizes the need for a realistic attitude in approaching each new situation. Progressive, confident, and well informed management, alert to the signs of economic change and adept at altering operating policies accordingly, can contribute greatly to the stability and orderly growth of our whole economy as well as to the continued sound progress of the savings and loan industry and all other financial institutions.

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