MONEY AND BUSINESS

by

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before

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Money and the supply of money are of vital interest to everybody, in one fashion or another.

Relatively few people, however, go beyond that. In other words, generally speaking, people don't realize that money includes not only currency but demand deposits (checking accounts), since both currency and checks are used in making payment for goods and services.

It is evident that there must be an appropriate relationship between goods and services, on the one hand, and money, on the other hand. If there is too much money in relation to goods and services available, money will tend to bid up prices; on the other hand, if there isn't enough money in relation to available goods and services or, putting it in reverse, if the flow of goods and services exceeds the flow of money, business activity will tend downward. As the demand for further production of goods and services falls off, unemployment will develop and unutilized capacity appears.

It is also evident that the economic situation is never quite as simple as this.

As a matter of fact, it is difficult, if not impossible, to know exactly and precisely how much money the economy must have in a given period in order not only to maintain economic stability at a high level of production and employment, but also to allow sufficient money supply to provide for the economic growth of our country. Therefore, we must be content with an informed "feel" of the needs of the economy for money.

The purpose of monetary policy is to add to or take away from the money supply, or, frequently, to stabilize the money supply in a given economic situation, always allowing, of course, for the necessary means of payment for a growing economy.

Our economy is free, dynamic, competitive, and complex. It is very seldom, indeed, that all sectors of our economy move in one direction, either up or down. Generally some sectors of the economy are remaining stable, others are moving downward, and still other sectors are moving upward. It is, therefore, the purpose of monetary authorities to judge whether, on balance, the economy is tending to move upward or downward.

This can be accomplished only by means of statistical and economic information, and an interpretation of the effect produced by some sectors of the economy upon other sectors of the economy. The reason for this is that judgment must be formulated in sufficient time so that monetary policy can contribute to, rather than hinder the development of sustainable economic growth. In this connection, the rate of turnover of the existing money is an important element in the formulation of policy. This means the use that the existing money is being put to.

The amount of money in the economy is generally dependent on the volume of loans and investments made by banks. Hence, monetary policy is basically credit policy.

The means by which the money supply and credit are affected varies among different countries. In the United States, we have three general monetary instruments. The first is reserve requirements--the amount of deposits that are frozen as a required reserve and, therefore, cannot be loaned or invested.

The second instrument is open market operations, which means essentially purchases and sales of U. S. Government securities in the open market by the Federal Reserve System. As securities are purchased, the Federal Reserve pays someone for these securities, and that money is deposited in a bank. That much money is added to bank reserves and becomes the base for an expanded money supply because the money comes not from another bank but from the Federal Reserve System. If the Federal Reserve System reverses the operation and sells securities, someone has to pay for these securities. That money is deposited in the Federal Reserve System and, therefore, taken out of the banking system of our country. The money supply tends to be reduced by a multiple amount of this transaction.

The third general instrument of monetary policy is "discounts and advances," and discount rates. When banks borrow from the Federal Reserve System, they obtain a temporary use of Federal Reserve dollars and thus add to their reserves and the money supply until they pay off their debt with the Federal Reserve System. Discount rates are the price at which this money is borrowed. In other words, it is the cost of borrowing money at the Federal Reserve

System by the banking system. I use the term "borrow" because most of the "discounts and advances" today are advances and not discounts, and an advance is borrowing.

The two instruments that receive most public notice through the press whenever a change is announced by the Federal Reserve System are "reserve requirements" and "discount rates." Open market operations receive very little public notice. Only those who know where to find, and how to read, the Federal Reserve statement published in the press will know whether the Federal Reserve has added to, or reduced, its holdings of Government securities and, therefore, will know whether on balance we have added to or taken away from bank reserves and the money supply through this channel.

The Federal Reserve has another monetary instrument which is not general but selective. It relates to the use of credit in the stock market--for the purpose of buying or holding securities. This instrument is called margin requirements and the Board of Governors has been given the responsibility by Congress to increase or decrease the amount of credit that can be used for this purpose. The Board has a regulation through which it affects such credit extended by brokers and dealers and another regulation through which it affects the amount of such credit extended by banks.

These three general instruments and, to a much lesser extent, the one selective instrument are the means by which the System influences the supply, the availability, and cost of credit and money. They are used differently at various times, depending upon the given situation.

Since 1953, the System has operated, first, to add to bank reserves and the money supply and then, in 1955, 1956, and most of 1957, to apply credit restraint. In the opinion of the System the economy in the period 1955-57 moved very fast on the up side and, therefore, money and credit had to be restrained from adding to the inflationary potential.

Since mid-October, on the other hand, the System has supplied reserves to the banks through open market operations by buying Government securities; has reduced its discount rates from 3-1/2 per cent to 2-3/4 per cent; and has reduced margin requirements from 70 per cent to 50 per cent.

There has been considerable talking and writing about a reduction in reserve requirements. The American Bankers Association has recently given much public notice to its plan for a legal change in reserve requirements. The proposal calls for a reduction of all member bank reserve requirements over the next several years to a level of 10 per cent on demand deposits and 2 per cent on time deposits, with Federal Reserve authority to vary the demand deposit requirement between 8 per cent and 12 per cent. Vault cash would also be counted as reserve.

This new plan compares with the present requirements of 5 per cent on time deposits at all member banks, and on demand deposits 20 per cent, 18 per cent, and 12 per cent respectively at central reserve city (i.e., New York and Chicago), reserve city, and so-called "country" member banks. Agitation has been especially great to remove the present disparity between reserve requirements in New York and Chicago and in reserve cities.

The economic situation is of concern to everybody--especially at this time. Industrial production fell by 6 per cent between August and December, and has probably continued downward since that time. About 3-1/2 million were unemployed in December, which represents a million more than a year earlier. There is clearly considerable excess capacity in many sectors of our economy.

Economists differ as to what this means; some say that this situation will get worse; others say that it is purely temporary and soon will get better. Whatever happens in the future, the situation is of immediate concern to the Federal Reserve System and, accordingly, the Federal Reserve System has been easing the credit situation for some time now.

While timing of monetary policy is important, flexibility of monetary policy is, likewise, important. The Federal Reserve System must be ready at all times to move in either direction at any given time, depending upon its interpretation of the current economic situation.

Fiscal policy--Government expenditures, taxes and the management of the public debt--are also very important to economic stability at a high level of production and employment. It is plain to see that as the Government spends more, that money is either taken from the people in the first instance through taxes, or borrowed through the issuance of securities. Sizeable orders given by the Government to industry are likely to increase production and employment. The community is, therefore, watching to see what happens in Congress to the budget proposed by the administration, and, also, whether or not the debt limit will be lifted, and by what amount.

Increasing the debt limit does not necessarily forecast deficit financing (that is, spending in excess of tax collections) because a primary purpose of the increase in the debt limit is to give the Government more leeway in borrowing money in anticipation of tax collections.

There are those who say that taxes should be reduced and deficit financing should be engaged in by the Government in order to stimulate the economy as much as possible through this means. There are others who say that taxes should not be reduced and deficit financing need not be engaged in; that the budget should be balanced, even though at a high level of expenditures. Regardless of one's feeling on this matter, it is a fact that the proposed budget is higher than it was last year. This, in itself, will be a stimulus to the economy.

Thus, we in the Federal Reserve System will be watching the developments in the economy as they occur during the next several weeks and months with special care so that we may note economic developments and take as promptly as possible appropriate monetary action that will aid economic recovery.

As indicated by the President in his economic report, two immediate concerns are potential wage and price increases. The President has asked that both labor and management, being aware of the present economic condition, should not add further disturbance to the economy by either wage increases that add to costs or by price increases not based on cost increases. For, as you know, the over-all cost of living has not been reduced--it is still at an all-time high. This is, therefore, a major problem at this time, as recognized by the President.

Your interest in small business is shown by your serving on the Advisory Committee in this district.

In this connection, I am told that during the past three years in which the Small Business Administration has been in existence it has approved 8,597 business loans for a total of $398,000,000 and 6,916 disaster loans for a total of $71,700,000.

The Small Business Administration has 15 regional offices and the Richmond regional office, composed of the same area as the Fifth District of the Federal Reserve System, has approved 475 business loans for $24,144,000 and 821 disaster loans for $5,862,000.

Therefore, it is natural for you to be concerned with the matters that I have discussed, because you must adjust your policies accordingly.

You will also be interested in knowing that the Federal Reserve is conducting a thoroughgoing study of credit to small business. This study, when completed, will be made available to Congress. We shall not formulate judgments about this matter until we have the benefit of the results of this study.

Monetary authorities can never rest; they must be constantly alert and always ready to act in whatever direction the situation may require action, because money is the hub of our economic wheel. It is a public responsibility and, therefore, policy must be conducted in the public interest.

I am glad to be with you and I shall be glad to answer whatever questions you may wish to ask, so far as I am able to do so.