

For release on delivery

(Approximately 2:00 p.m.,
Pacific Standard Time,
Thursday, April 9, 1959)

THE SAVINGS PROCESS AND MONETARY POLICY

by

M. S. Szymczak

Member, Board of Governors,

Federal Reserve System

before the

Twentieth Annual

Pacific Northwest Conference on Banking

at the State College of Washington

Pullman, Washington

April 9, 1959

Your conference has a special place in my heart and mind. You asked me to participate in your first conference in 1936 and again later in 1949, and while 23 years have elapsed since 1936 this is the Twentieth Annual Conference because during the war the conference was suspended. And now again you asked me to participate and again I join with you in search of economic and financial information to serve the public interest through our contribution to a stable high level economy--and so I thank you sincerely and cordially for giving me this opportunity to join you in your deliberations.

Much is being said and written on economic growth, on stock market prices, on inflation, on Treasury financing, on interest rates, and on unemployment. Therefore, with your permission and tolerance I shall today speak of saving. That seems particularly proper before this group and at this time--if you will bear with me--because saving is fundamental in any discussion of economic and financial questions--whatever they may be.

We shall proceed to attempt answers to three questions: first, what is saving; second, what influences saving; and third, what have been recent economic developments. First, though, we need to take note of where saving fits into the whole range of considerations influencing the formulation of monetary policy.

As you know, policy formulation focuses on the strategic aggregate changes that indicate the level and possible future direction of economic activity. These include, of course, measures of production, prices,

and employment. Business expenditures for plant and equipment, consumer spending and saving decisions, and governmental budgetary policy are all evaluated in terms of their effect on these variables. Monetary policy and actions, effected through their impact on bank reserves and money markets, are designed to foster continued growth in output, relative stability of average prices, and high and rising levels of employment.

It is plain to see that one of the key economic processes influencing the direction and pace of economic activity is the formulation of saving and its flow into various investment outlets. Saving serves a dual purpose. It provides funds needed for capital formation and, thus, contributes to the economy's growth potential; for example, purchases of new security issues or additions to savings deposits provide financing for expenditures on such items as plant and equipment or housing which, in turn, lead to the output of additional goods and services in the future. At the same time, the willingness to save, by reducing what the nation attempts to spend currently on consumption goods, inhibits the development of inflationary pressures at times when the economy is operating at near full capacity.

It is evident, thus, through its influence on the saving-investment process, monetary policy affects the path and pace of economic growth. With active investment demand, actions which encourage saving help maintain growth with relative stability of prices. In periods of slackening demand, on the other hand, monetary policy contributes to renewal of economic expansion by increasing credit availabilities and lowering interest costs.

Now let's look at the foundation.

What is saving?

I need not tell you that there is a good deal of misunderstanding or confusion surrounding the term "saving." Few people--only a few in these days to be sure--consider only whatever cash they have stuffed into mattresses or other hiding places as saving. Others realize that their savings deposits in banks or shares in saving and loan associations are saving; and still others, who own securities, consider them to be saving, though of a less liquid variety. Finally, many are aware that they have saving in the form of life insurance or pension plans.

As we can see, these different kinds of financial assets have one thing in common. They represent claims on the future; and, for giving up the present use of his funds, the owner generally receives a return in the form of interest, dividends, or future annuities. They differ, however, in other characteristics--in liquidity and, to a degree, in function.

It is elementary, and not difficult, to observe that some claims are immediately redeemable without danger of a loss in value, such as savings deposits; these store-of-value claims are the most liquid of assets. Others, such as securities, can be sold at any time for cash, but with the possibility of some loss, or gain, in value. Still other claims, such as pension plans, are not generally redeemable in the present, but do embody a right to future income.

What's more, since they are a claim on the future, demand deposits and currency in circulation are also a form of saving, in the sense that I am using the word here--even though fluctuations in these balances are affected more by monetary policy and transactions needs than by saving propensities.

And so, the general meaning of saving, as reflecting claims on the future, can be expanded to include tangible assets such as plant and equipment or homes, which yield services over time. Many would also place consumer durables, such as automobiles and household equipment, in this category.

We cannot say that the purchase of an automobile is saving. The purchase is an investment, just as business purchases of plant and equipment are properly termed investment. In fact, all the financial and tangible assets I have previously mentioned, though of varying liquidity and function, are alike in that they are investments; in other words, they are uses or forms of saving.

Thus, the amount of saving that you or I or a business generates in any period either flows directly into capital expenditures or is made available as financing to the rest of the economy. The nation's saving, however, in contrast to the saving of any one group is reflected only in expenditures on capital goods yielding services over a future period and net foreign investment. Financial claims and debts held and owed within the domestic economy balance out; for example, consumers' saving in the form of deposits is balanced off by the increase in banks' liabilities.

After allowance for capital consumption, national saving reflects the amount by which the nation's stock of capital or tangible wealth has risen during the year. This stock of capital embodies the nation's potential for economic growth, and it is important to maintain the flow of saving at levels necessary to the continued expansion of this stock.

The interrelations between saving and investment flows among the groups in the economy have been under intensive staff study at our Board for some time now. One aspect of this work has been the development of a set of social accounts which, in an integrated fashion, will show the amount of saving and the forms of investment--except for government tangible assets--that saving takes for all sectors of the economy and for the nation. These accounts will be published on a regular quarterly basis sometime after mid-year.

I am advised by the staff that they will provide information suitable for a number of different purposes and users. With respect to savings institutions, for example, you will be able to see the portion of consumers' saving that is flowing into savings deposits as compared with all other forms. In addition, through simultaneous presentation of financial sectors, you will be able to trace through the use of these funds by savings institutions and compare it with the use of funds by other financial institutions. These accounts will add another dimension to our understanding of saving and financial processes.

Influences on saving

It is basic to say that the nation's saving and investment, while measurably equal, reflect different economic processes. Furthermore, to a great extent saving decisions and investment decisions are made by different groups in the economy. Generally speaking, most of the saving in the country is generated by consumers. Most of the investment, on the other hand, is generated by business.

While the interest rate is a strategic factor in maintaining a balance between the supply of saving and investment demand, it is not the only influence. Another important factor is the fluctuation in the level of income, and still another important factor in maintaining a balance between the supply of saving and investment demand are consumer and business expectations of future demand and price conditions.

Therefore, the impact of conditions of monetary ease or tightness on the flow of saving is seen in a number of ways. Variations in the level of interest rates may, as I have mentioned, affect the amount of saving people are willing to make available. Beyond that, and perhaps more important in the long run, monetary actions to maintain stability in the price level are an essential condition to maintenance of the incentives to save and invest.

As you know, of course, in those periods when recessionary tendencies are dominant in the economy, there may seem too much rather than too little saving in relation to the demand for it. At these times greater consumer spending will help brace the economy and pave the way to renewed expansion, just as lower consumer spending serves to dampen inflationary pressures when the demands for saving are outrunning the supply.

The pattern of saving

Now let's take a look at the pattern of saving, since one of the most fruitful ways to view the shifting forces of saving supply and

demand is to look at the pattern of sector saving in financial form. For example, the saving in financial form of consumers represents funds made available to the rest of the economy to help satisfy business and government financing needs. In a measurable sense such saving is reflected in the net increase in consumers' financial assets after deducting the net increase in their debt.

As we said before, at times when saving exhibits some sensitivity to interest rates, it usually shows up through fluctuations in the financial forms of saving. Sometimes the aggregate amount of this saving is affected. More often, there are important changes in the pattern of saving flows in response to evolving interest differentials. In recent years there has been evidence of this from shifts in the flow of saving as among demand deposits, saving deposits, saving shares, and Savings Bonds. Of course, these shifts, when observed, are only partly a response to interest differentials. Other factors--such as the degree of speculative activity in the stock market, awareness of alternatives, or expectations concerning the future--have their influence; and, in practice, it is always problematical how to weight these influences in importance.

Let me repeat what is elementary, namely that while consumers generally save in financial form, businesses generally dissave. In most years the liabilities of businesses, including corporate stock outstanding, will rise more than their financial assets, as businesses absorb funds net from the rest of the economy principally to finance their

capital expenditures. The shifting relationships of consumer and corporate saving in financial form during recent years are illustrative of how the changing magnitude of saving flows can both contribute to growth and help maintain stability.

Now, let's look at the economic structure.

Saving-investment process, 1955-1957

Before discussing the events of last year, I would like to review briefly some highlights of the 1955-57 period, since the experience of those years may help us in understanding current developments. For most of that period, you will recall, the economy was in an expansionary phase, following the brief recession of 1953-54.

In 1955 consumers provided the main impetus to economic expansion through increased purchases of durables and homes. This was accompanied by a sharp reduction of their net saving in financial form to about \$2.5 billion from an average of around \$8.0 billion in the preceding three years. This small net saving occurred even though growth in assets--including equities in life insurance and private pension plans--was actually somewhat larger than in the previous years. The explanation lies in the record expansion of consumer debt in that year. In other words, to finance their own investment, consumers were borrowing back from credit markets a substantially larger share of what they were making available through net additions to asset holdings and repayments of old debts. This was obviously a force tending to raise the interest rates at which businesses and governments could borrow.

By the latter half of 1955 and through 1956 business capital expenditures were expanding rapidly. These expenditures rose further in the first months of 1957, then eased off slightly, but remained at high levels through the summer. Over this period, capital markets were under considerable demand pressures, and there was a sharp and prolonged rise in long-term interest rates. Short-term interest rates, which had risen markedly in 1955, continued to move upwards.

In the face of buoyant investment demands and higher interest rates and yields, consumers began to increase their saving in financial form. It reached almost \$7.0 billion in 1956 and a record \$12.0 billion in 1957. Partly, this was the result of a smaller expansion in debt, as consumer expenditures on durables and homes declined somewhat. Partly it reflected larger acquisitions of financial assets by consumers. One aspect of this was the increase in funds made available to business directly through consumer purchases of corporate securities.

There was unusually large growth in consumers' savings deposits in commercial banks during 1957. The maximum interest rates payable on their savings and time deposits were raised, as you remember, in the beginning of that year; and this reduced the spread between the yield on deposits at commercial banks and other closely competing forms of saving.

We can see that in this period the role of consumers was, by and large, a stabilizing one. Although it is dangerous to reason backwards from figures on what consumers actually saved to a conclusion about what they were willing to save, in practice that is all we can do. And

it would seem that consumers were willing to save more at that time. This freed resources for the investment boom and to some extent lessened pressures on prices. The increase in saving in part may have responded to, but surely complemented, monetary restraint in the period.

Recent developments

The recession that began in the summer of 1957 was brief. Since the spring of 1958 most general economic indicators have been rising. By the end of 1958 the gross national product, in both money and real terms, was above its pre-recession peak. Industrial production has risen steadily, and in January of this year was only two per cent below the previous high. Unemployment began to decline after the summer months of 1958, when it was 7.5 per cent of the labor force, and in the beginning of the year was at a six per cent rate.

These gains were the result of, mainly, increased government expenditures on goods and services, a decline in the rate of inventory liquidation, and a spurt, toward the end of the year, in residential construction and automobile sales. Business investment in plant and equipment remained at relatively low levels.

During this period--one of slackening business and expanding government demand--consumers' saving in financial form remained at high levels. The composition altered, however. There were smaller net purchases of securities, but larger additions to holdings of more liquid forms of saving. The flow of consumer funds into time and savings deposits at commercial banks remained high, though dropping off toward

year-end. In addition, there was an unusually large rise in deposits at mutual savings banks and in shares of savings and loan associations last year.

In the meantime, business dissaving in financial form during 1958 was cut back sharply. There was a marked decline in corporate profits in the first half of the year followed by a substantial recovery after mid-year. With relatively low demands for funds, corporate liquidity was considerably improved in the last half of the year.

The availability of business funds toward the end of 1958 and in the beginning of this year helped the Treasury at a time when it was faced with a large cash deficit, on top of its refunding operations. It was a factor at that time in permitting the placement of a substantial portion of Federal debt with nonbank lenders.

The high rate of consumers' saving in financial form in recent years is, in one sense, an encouraging sign for the future. With a rise in consumer incomes and favorable expectations, this growth in liquidity provides a basis for an acceleration of consumer spending. On the other hand, a possible upsurge of consumer demands might occur in conjunction with renewed business demands. Extra encouragement given to consumer and business demands by the previous build-up of liquidity could release strong inflationary pressures in the economy. As you can see, it is on such mixed blessings that monetary authorities must always keep a constant and most watchful eye to formulate judgments in the field of monetary policy.

Let me close by saying that we can't resolve economic and financial problems without careful study. And it's conferences like yours that beget such study--as is evident from this gathering and this program. I congratulate and thank you.