

FOR RELEASE TO AFTERNOON NEWSPAPERS
Tuesday, May 24, 1960.

MONEY, SAVING AND GROWTH

by

M. S. Szymczak

Member of the Board of Governors

of the

Federal Reserve System

before the

Illinois Bankers Association

Palmer House,

Chicago, Illinois

Tuesday, 1:00 p.m. C.D.T.
May 24, 1960.

MONEY, SAVING AND GROWTH

The international developments that have dominated people's thinking in recent weeks have also introduced new elements that complicate assessment of the course of economic and financial affairs here at home.

The fact that these developments are still in process makes it impossible for anyone to foresee at this time what they will produce, or what the effects upon our economy will be, but already they have reemphasized the necessity for keeping our economy on a sound, strong and progressive footing.

Economic activity, despite some slackening in February and March, achieved in the first quarter a record level, and expansion was resumed in April. Recent improvement rests to a large extent on two factors--first, increasing consumer purchases, particularly of automobiles, following the advent of mild weather, and, second, reconfirmation of business plans to ~~increase~~ outlays for plant and equipment. In the last six months, moreover, there has been some ebbing of inflationary pressures and expectations.

Current Economic Situation

Reviewing somewhat more specifically the current economic situation, preliminary estimates indicate that the gross national product was at a seasonally adjusted annual rate of half a trillion dollars in the first quarter, the highest on record. The gain over the last quarter of 1959 was nearly \$17 billion. About half the gain was accounted for by inventory accumulation as steel producers and users rapidly replenished inventories after the strike and as dealers

accumulated stocks of new automobiles. Investment in business plant and equipment and exports of goods and services were up markedly. Moderate increases occurred in consumption expenditures, mainly for services, and on Government purchases of goods and services.

The industrial production index in March and April was 109, two points under the January level of 111 largely as the result of the decline in steel and auto production. The steel rate is now about 70 to 75 per cent, not far apparently from the current rate of the use of steel in consuming industries.

The advent of spring weather was reflected in strong gains in retail sales in most lines. Sales of new domestic and imported autos were at an annual rate of about 7 million cars in April and early May and other durable goods sales were also at high levels during the past month.

Continuing strength in the over-all economic situation and in businessmen's confidence in the future was indicated by the recent McGraw-Hill Survey of business plans for capital spending. The survey, taken in late March and early April, indicated expenditures of almost \$38 billion in 1960, 16 per cent more than last year. A rising trend of outlays in 1960 was also shown by a survey conducted earlier in the year by the Department of Commerce and the Securities and Exchange Commission. In that survey the indicated increase was 14 per cent over 1959. New capital appropriations as reported to the National Industrial Conference Board also promised a further rise in fixed capital outlays.

Current Financial Developments

Inflationary expectations dominated the behavior of financial markets through much of the second half of 1958 and into the late summer of 1959. Stock prices rose and yields on fixed income securities substantially exceeded those on stocks. Declines in stock prices during the early months of 1960 and moderate bond price recovery narrowed the spread, but bond yields are still about one percentage point above stock yields.

Money market rates have fluctuated considerably in recent months. Rates on three-month bills, for example, declined sharply during the first quarter to a low of 2.84 per cent near the end of March. Thereafter the bill rate rose, and recently it has been fluctuating approximately between 3 and 3-3/4 per cent, still substantially below the early 1960 peak of 4.60 per cent.

In the monetary field, the reserve position of the banking system has eased somewhat. The decline in the money supply, which had been taking place since last July, appears to have ceased in recent months. Financial markets, always sensitive to changes in trends of business activity and expectations, show that investors have not made shifts in holdings of a size that would indicate a decline in confidence in business prospects for 1960. Financial attitudes may be somewhat less exuberant than in 1959, but this has tended to strengthen rather than weaken financial markets.

Financial Saving

Recent economic and financial developments and reduced inflationary psychology have been affected by and have in turn influenced the recent course of financial saving. The savings process can be viewed in various ways. First, saving can be viewed in the aggregate; the nation's aggregate saving is equal to its income less current consumption. But this aggregate description of saving does not tell us much about flows of financial saving and their relevance to the course of economic activity. To understand and analyze these flows, one has to look separately at saving by consumers, businesses, and all levels of Government. A sector's saving, together with its incurrence of debt, finances not only its acquisition of tangible assets--for example, in the case of consumers, homes and autos--but also becomes available to the economy through acquisition of financial assets--for example, again in the case of consumers, Government securities and time deposits.

Consumers do most of the economy's saving. In 1959 their gross saving amounted to almost \$75 billion, more than three-fifths of the nation's total saving. A substantial portion of consumer saving flows into financial assets. In 1959 consumers made net acquisitions of financial assets of almost \$35 billion. Of this total about a third was in the form of time deposits, savings and loan shares, and U. S. Savings Bonds. Saving through life insurance and pension

funds accounted for another third. The remainder was in the form of acquisitions of securities such as marketable U. S. Government bonds, State and local government obligations, mortgages, and corporate bonds and stocks.

A number of factors influence the financial forms in which consumers save and these change from time to time. Consumer uncertainties with regard to employment and income may induce them to sacrifice interest and dividend income for liquidity and safety. On the other hand, higher interest rates induce consumers to move out of money into interest-bearing forms of saving. In 1959, for example, individuals regarded as attractive issues of marketable Government securities carrying rates of interest higher than those on institutional forms of saving, and shifted some of their funds to the higher yielding investments.

Concluding Comments

Monetary policy makes an important contribution to consumer decisions to save or spend. By influencing economic activity and growth, particularly by contributing to the maintenance of stability of the price level, monetary policy encourages saving. Growth in the economy is dependent on saving and reflects to a large extent the amount of resources directed to capital goods production rather than to production for current consumption. The more resources are used to increase future production the higher the growth rate is likely to be. Furthermore, by moderating cyclical swings that interrupt growth,

and by stabilizing prices, monetary policy is a necessary ingredient of the growth process.

In the current business cycle, as in past cycles, monetary policy is playing a stabilizing role. By restraining the growth of bank credit and money during expansion the Federal Reserve System makes an important contribution to price stability and dampens anticipation of inflation.

Higher interest rates in 1959 were a consequence mainly of strong borrowing demands relative to the available supply of savings. Although these higher rates induced a larger flow of saving into financial assets, even this increased flow fell short of capital market demands and market rates and yields continued to rise. More recently, rates seem to have reached a level more consistent with changes in market and business expectations regarding the threat of inflation.

The recent course of international events underlines the fact that there is constant change in the economic environment in which monetary policy plays a part due to a variety of causes--economic, political and social, not to speak of structural changes. As a result, monetary policy must undergo frequent change, nevertheless at all times contributing to the basic soundness of our financial system. There can be no rigid formula for monetary policy to follow. Monetary policy must be flexible, and a flexible policy requires a constant flow of accurate economic intelligence as well as sound judgment.