PRESS RELEASE

To afternoon newspapers
Tuesday, March 21, 1961

Remarks On Consumer Credit Trends

by

M. S. Szymczak

Member of the Board of Governors

of the

Federal Reserve System

before the

American Bankers Association

Annual National Instalment Credit Conference

Conrad Hilton Hotel,
Chicago, Illinois.

March 21, 1961

The Federal Reserve System has three principal responsibilities--bank supervision, fiscal agency functions, and monetary policy. Each of these covers a wide field of interest and a large area of activity. All of them have a relationship to credit--especially monetary policy. All of them require much research, for which the Board has a well-qualified staff.* Therefore, I feel competent to speak before this Conference, but more importantly I am pleased to be here.

First, I should like to say something about the trends that have been in operation in the consumer credit industry for a number of years. Then I should like to see what modifications of earlier conclusions may be suggested by developments of the past few years.

Nothing is more illustrative of the changes in the attitude toward consumer instalment credit and the dynamic character of the industry than the rapid increase in commercial bank activity in the field. It is hard to realize now that commercial bank instalment loans were negligible until the late 1920's and that not until about 1935 did banks hold as much as 10 per cent of all instalment credit. By the end of the 1930's, however, the bank share had risen to about 25 per cent, and during the postwar period banks have consistently held just under 40 per cent of a growing volume of instalment credit. All but about 175 of the 13,000 insured commercial banks now make instalment loans. Instalment credit constitutes about 8 per cent of the total loans and investments of all banks, and the proportion exceeds 10 per cent for banks with total loans

---

*Practically all of the data I shall submit here today were compiled by our Division of Research and Statistics. They have been brought together by Miss Mona E. Dingle, Chief, Consumer Credit and Finances Section.

and investments of $5,000,000 to $100,000,000. I do not need to emphasize to this group how actively banks have competed for consumer loans over the past 30 years.

Developments in Consumer Credit, 1930-55

The rapid growth in commercial bank activity in the consumer credit market over the past several decades has reflected both the changing attitude toward instalment credit generally and the ready availability of reserve funds over a substantial part of the period. As expenditures for automobiles and household appliances formed an increasingly important part of a rising level of consumer expenditures, more and more consumers made use of credit to finance the purchase of such items. It was recognized that these were large-ticket durable items for which expenditures were "lumpy" and which would provide services over a period of time. There was increasing acceptance of the appropriateness of consumers' financing purchases of these items by borrowing and repaying their indebtedness as they used them. It was observed that borrowers for the purchase of these items are not the impecunious but are predominantly young, middle-income families who can look forward to increasing incomes over future decades. Moreover, it was noted that these items could be repossessed and, at least in the case of automobiles, resold in an active market.

The rapid increase of bank activity in consumer credit reflected also the availability of a large volume of excess reserves during the 1930's and of Government securities that could be sold at pegged prices in the early postwar period. While seeking outlets for loanable funds, banks made a number of discoveries about consumer loans. First, they learned that consumer loans were sound loans. Even during the depressed 1930's, consumers did a remarkable job of repaying debts. Defaults declined to very low levels during the war and early postwar periods.

Second, banks learned that consumer loans are very profitable loans. Most banks have discovered that their consumer credit departments are among their most profitable departments, despite relatively high administrative costs and laws limiting interest charges. Such loans seemed particularly attractive with the excess reserves of the 1930's and the continued low interest rates of the immeidate postwar period. They have continued to be attractive, however, despite the higher levels of interest rates and security yields prevailing in recent years.

Banks also discovered that consumer credit was an area with rapidly expanding demand. Again, this was of particular importance when banks had excess funds and demands for other types of loans were depressed. It has continued to be important, however, as more and more banks have come to consider consumer loans an important part of their portfolios. Many banks learned that they could make direct loans to consumers while continuing to supply funds to other types of consumer lenders. I am sure that many, if not most, of the banks represented here make direct loans to consumers, purchase paper from retail outlets, and at the same time lend to retail outlets and finance companies for the purpose of carrying consumer paper.

In the decade following the close of the war the growth in instalment credit was particularly rapid, giving rise in some quarters to expectations of continued growth at astronomical rates and in others to fears of a drastic cutback resulting from the high percentage of consumer incomes being devoted to debt repayments. Consumers incurred debt to meet the backlog of deferred demand resulting from wartime shortages. Increasing home ownership and the move to the suburbs together with increased incomes gave rise to the two-car family, which constituted

12 per cent of all families by the end of 1955. The rise of new products, such as television, and the improvement of old products were further factors in credit expansion. New types of credit plans permitted the substitution of instalment for charge account credit, and increased demand for services such as travel and education encouraged the expansion of credit for these purposes.

Instalment credit controls were reimposed on two occasions--in 1948 and again in 1950--to moderate expenditures for durable goods and the expansion of credit. The removal of credit controls in each case was followed by an easing of credit terms which both encouraged consumer expenditures and intensified the effect of the expenditures that took place. After a moderation of credit growth in 1954, outstanding credit rose 23 per cent in 1955 as automobile sales reached a record high and terms eased sharply further. At the end of 1955, total instalment credit was 12 times as high as 10 years earlier and automobile credit was 30 times as high. The ratio of debt payments to consumer disposable income reached 12-1/2 per cent in 1955, compared with 3-1/2 per cent in 1945. To many it seemed that the demand for consumer credit was insatiable. There seemed also to be an almost unlimited supply of credit as banks and other lenders competed aggressively for business. To many observers it seemed that consumer credit controls were the only way to prevent continued sharp inflationary pressure from increased credit purchases and continued easing of terms.

What Have We Learned from Recent Developments?

In what ways have developments over the period since 1955 modified interpretations of consumer credit trends? Few would suggest that the trends just discussed have been reversed or that the basic quality of consumer credit has changed. I do believe, however, that developments over the last five years have taught us some new lessons about consumer credit--or, rather, retaught us some old lessons. I think that recent developments have pointed up the unusual nature of the early postwar period and the exceptional combination of circumstances that made 1955 possible. At the same time, they have emphasized the continued dynamic nature of the consumer credit industry.

What are the lessons that we have learned from developments of the last 5 years? First, I think that we have learned that consumer credit growth at the rate of the early postwar period was an unusual development that is not likely to be repeated under normal peacetime conditions. The rapid increase of credit in that period was associated with the backlog of deferred demand, the small volume of indebtedness at the beginning of the period, far-reaching social and economic changes, and expectations of continued inflation on the part of much of the public. I think that it is now generally recognized that the period 1946-50 was largely a catching-up period. The ratio of debt to disposable income was about the same in 1950 as just before the war. Developments in 1955 reflected an unfortunate combination of record automobile sales and sharp easing of credit terms. Since then we have learned that such a growth rate cannot be sustained. Moreover, we have learned that reductions in consumer credit may take place in periods of recession, and that these reductions are likely to be the greater the more excessive was the preceding credit expansion.

We have also learned that automobile credit is not necessarily the dominant factor in the expansion of instalment credit that it seemed in the early postwar period. Expenditures for automobiles have increased less rapidly than many other types of consumer expenditures in recent years. Meanwhile, many of the factors which earlier resulted in such sharp expansion of automobile credit in relation to sales have not been operating to the same extent in recent years. At the end of 1960, automobile credit accounted for about the same proportion of total instalment credit as at the end of 1953--slightly more than 40 per cent. This was also about the same proportion as in 1941. Personal loans increased from 21 per cent of the total in 1953 to 26 per cent in 1960, while other consumer goods paper declined from 29 to 26 per cent. Before I discuss these developments in more detail, let me mention two other lessons that I believe we have learned from recent developments.

One more lesson that we have learned is that there are such things as delinquencies and repossessions on consumer loans and that these need to be taken into account in administering consumer loan departments. Despite the generally good record of consumers in paying their debts, we have learned that not all consumers discipline themselves adequately and that many will attempt to borrow more than they can service from their incomes. We have also learned that recessions may convert otherwise sound loans into at least temporary defaults. We have learned that dealers that have sold recourse paper can go into bankruptcy, and that lenders can lose money on repossessions in a declining market. I know that a number of lenders are now operating with the highest delinquency and repossession rates of the postwar period. Others are spending increased time and money in collecting overdue loans and in screening new loan applications. Many lenders have learned to their regret that injudicious promotion efforts may require a high refusal rate if a rise in delinquencies is to be prevented.

A fourth lesson that we have learned is that consumer loans are affected by limitations of credit supply as are other types of credit. We have learned that loanable funds cannot be made available in unlimited amounts in periods of prosperity and high level demand without encouraging inflation, and that restrictions on the growth of credit affect consumer as well as other types of credit. As long as banks had excess reserves or large amounts of securities which could be sold at pegged prices, and as long as they were actively interested in expanding the proportion of consumer loans in their portfolios, this limitation did not come into play. In the past decade, however, we have relearned the lessons of credit restriction in all areas. Credit restriction appeared at times not to affect consumer loans as banks as well as other lenders competed actively for such loans. As consumer loans have increased in proportion to bank assets, however, banks that have been pressed for funds have restricted expansion in this as in other areas. No doubt many of you were among the lenders who were curtailing promotional efforts sharply, screening loan applications more carefully, exercising caution in taking on new dealer accounts, and upping interest rates on some types of loans a year or so ago. Some of you have also discovered, however, that it may be difficult to apply the brakes on consumer credit expansion if there has previously been injudicious promotion or sharp easing of terms.

Changes in Outstanding Credit, 1955-60

Having summarized the lessons that we have learned from developments of the past few years, let me review these developments in somewhat more detail, with special reference to changes in automobile credit. In 1955, as you are aware, automobile credit increased 37 per cent and other instalment credit about 13 per cent. The sharp increase in automobile credit reflected in considerable part the record 7.4 million new cars sold. Meanwhile, however, developments were taking place in the market for automobile credit which both made these sales possible and intensified their effect on outstanding credit. The average size note on new car contracts rose sharply as automobile prices increased, consumers upgraded their purchases, and the real down payment ratio declined. The proportion of automobiles bought on credit also increased substantially. Meanwhile, the rise in repayments was moderated by the lengthening of average maturities as first 30- and then 36-month contracts became common.

The continued operation of most of these factors in 1956-57 kept extensions above the rising level of repayments despite a drop of almost 20 per cent in new car sales. By the end of 1957 almost one-half of all new car contracts were being written for 36 months. The average size note on new cars was about one-third higher in 1957 than in 1954. The proportion of cars bought on credit rose about one-sixth from 1954 to 1956 before declining slightly in 1957. Automobile credit, however, rose more moderately than other types of credit in the 1956-57 period--an average annual rate of 7 per cent, compared with 10 per cent for nonautomotive instalment credit.

A further sharp drop in automobile sales in 1958 reduced extensions below repayments. Outstanding automobile credit declined 8 per cent during the year while other types of credit continued to rise.

Automobile credit extensions picked up with automobile sales in late 1958, but in the period 1959-60 automobile credit rose slightly less than other instalment credit--an annual average rate of 12 per cent, compared with 13-1/2 per cent for nonautomotive credit. The average size note declined slightly as manufacturers failed to increase prices for the first time in several years and compact cars became an important element in total sales. Down payments and the proportion of cars bought on credit were unchanged. By late 1959, 36-month contracts on new cars accounted for about two-thirds of all contracts, but the proportion showed little further change in 1960. As you are well aware, the much-heralded 42-month contract failed to materialize. The growth of other types of credit in this period, however, was encouraged by promotions, by the adoption of new types of credit plans, and in some cases by an easing of terms. Automobile credit began to decline at the end of 1960, but personal loans continued to increase.

Future Trends

What conclusions can you draw from the past with respect to probable future developments in consumer credit? It is obvious that whether the early-1961 decline in instalment credit will continue will depend largely on changes in consumer demand, particularly for durable goods. I do not think any of you expect a decline of major proportions in consumer credit. On the other hand, consumer credit as such cannot be expected to pull us out of the current recession. When consumer demand revives, however, consumer credit should be a contributing factor to the upswing.

Over the longer run, you would expect a continued growth in consumer credit as population and income increase and new items are bought on credit. You would expect, however, that the rate would be substantially slower than in the first postwar decade, and obviously you would expect periods of cyclical expansion to be followed by moderate declines.

The ratio of consumer debt payments to disposable income may rise moderately from the rate of slightly more than 13 per cent which has prevailed since the second half of 1959. The large baby crop of the war and immediate postwar periods will be reaching maturity and setting up homes. Older people will also form an increased part of the population. This group has always accounted for a small part of total consumer debt, but the incidence of debt may rise as an increasing proportion of older people are accustomed to the use of instalment credit and continue to have regular incomes after retirement. To the extent that an increase in instalment credit reflects rising incomes and an increase in the number of creditworthy families using such credit, it is of course no cause for alarm.

Next, you would probably expect new items and the newer types of credit plans to continue to account for an increasing share of total instalment credit. The proportion of credit accounted for by the traditional types of household durable goods has been declining for some time. You might question how much further automobile demand can increase, in view of the very high incidence of automobile ownership and the number of multiple-car families at the present time. On the other hand, other types of large-ticket items are becoming an increasingly important part of what Americans consider the good life. You might also expect a continuation of the trend toward the use of revolving credit accounts for making a variety of purchases.

Many of the big-ticket items that are entering into the standard of living of more and more Americans are durable goods like boats and camping equipment. Others are services like trips to Europe and college educations. Many of these services are "lumpy" in the same sense as purchases of durable goods--that is, they are made infrequently and they involve expenditures that are large relative to consumer incomes. The response of lenders to these new demands has illustrated the continued dynamic character of the consumer credit industry. On the other hand, some of these new types of credit may involve dangers if injudiciously promoted. Acceptance of the widespread use of consumer credit for the purchase of durable goods has been based in part on the fact that consumers were paying for goods as they were using them. I believe that there is a limit to the extent to which consumers can be expected to allocate current income in payment for purchases from which they are no longer deriving utilities. This danger is likely to be greatest in the case of expenditures that are in fact of a more-or-less regular nature or are likely to be repeated at intervals shorter than the maturity of the debt. The danger may be aggravated in some of the new types of credit plans that do not require a complete pay-off of debt incurred in connection with specific purchases.

Finally, on the basis of recent developments you would expect consumer credit to continue to show more sensitivity to developments in general credit and monetary policy than in the past. In view of recent increases in loan-deposit ratios and in the ratios of consumer loans to total loans, more and more banks will probably find it necessary to restrict expansion of consumer as well as other loans in periods of credit restraint. By the same token, other consumer lenders will also find it difficult to raise sufficient funds for unlimited credit expansion. I do not say that general credit and monetary policy can prevent all excesses in the consumer credit field in the future. I do believe, however, that the apparent insensitivity of consumer credit to general credit and monetary policy in some past periods has been associated in part with special conditions in the financial system and in the economy generally. After recent developments lenders may be less eager than in the past to enter into excessive credit easing or promotions that may be difficult to curb.

* * * * * * *

As in all things, we have much to learn, not only about consumer credit, but also and especially about its use. Experience teaches discretion. As in life generally, so in this field abuses and excesses have been experienced that were not in the interest of the borrower or the lender and of course not in the public interest. Nobody knows that better than you, and nobody can contribute to the welfare of the consumer credit industry as effectively as you. Your discretion is essential to its sound economic and social contribution.