For Release on Delivery

(Approximately 2:00 p.m.,
Tuesday, September 15, 1964)

THE SIAMESE TWINS--FINANCING AND MARKETING

Remarks of C. Canby Balderston,

Vice Chairman, Board of Governors of the Federal Reserve System,

Before the Cleveland Chapter of the American Marketing Association,

Cleveland, Ohio,

on Tuesday, September 15, 1964.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

THE SIAMESE TWINS: MARKETING AND FINANCING

Money is to marketing what gears are to a machine. It links the parts of our economy together by facilitating the movement and exchange of goods. And it is vital to trade among nations.

In its relation to marketing, money is needed to effectuate transactions. As such it is a medium of exchange. But it is used also as the unit of account for dealings between creditors and debtors, so that the savings of our people can be put to work by business and other borrowers. Unless stable in value, however, money and fixed-money claims will not command the confidence of savers.

Money itself takes a variety of forms. First there is small change. In this country, some 45 billion small coins are outstanding, but the current craze to collect them for speculation has induced merchants and others who need coin for the conduct of daily business to hoard them also. The scarcity value that the speculative collector seeks is anathema to the merchant, the automatic vendor and the public utility, but these, too, may be tempted to hoard in order to assure themselves of enough coin to conduct business efficiently.

Then there is currency (i.e., paper money), the volume of which has been rising markedly. In wartime, large bills were in vogue for purposes of hoarding and tax evasion. Now these explanations do not seem valid and so the growth of paper money in circulation, from $32-1/2 billion to $34-1/2 billion in the past year must be ascribed to expanding business, with its fatter pocketbooks, and perhaps to some movement into other countries.

LIBRARY

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

By far the most important form of money proper is checkbook money, based on demand deposits in commercial banks. In this country, unlike many others--even those with highly developed economies--check money is over three-fourths of the total. It amounts to nearly $125 billion of the total money supply of $158 billion.

If we turn away from these media of exchange to the function money performs as a store of value, we encounter a wide variety of money substitutes or near-monies. These are not money in the narrow sense, but they can be liquidated so readily as to be regarded by people and businesses as practically the equivalent of cash. Examples are the savings deposits of individuals and the time deposits of corporations. Included, too, must be savings and loan shares, U. S. Savings Bonds and short-term Government securities, to say nothing of such sophisticated forms of corporate liquidity as commercial paper, sale and repurchase arrangements with securities dealers, and placements in the Euro-dollar and other international markets. In domestic forms alone, such liquid assets amount to about $370 billion, more than double the amount of currency and checking account money outstanding.

So far I have mentioned only money and near-monies, without any mention of credit. But credit is merely the other side of the coin. The marketing executive's interest in credit extends to both availability and cost, for himself and also for his customers. Credit permits merchants to carry inventory and customers to buy before they have saved enough to pay the bill. Credit also finances investment in long-lived assets, such as homes and plant and equipment.

The exchange of ready funds for credit claims is accomplished by having those who would borrow offer those who would save a sufficient

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

inducement to forego the immediate use of their funds and accept the risks involved in the loan of their savings. In consummating this exchange, the function of commercial banks and other financial intermediaries is to stand between the ultimate participants--the savers and borrowers. They perform this intermediary service by obtaining funds from savers and then passing these funds on to individual borrowers, and in the process themselves take on the credit risks involved. This flow from savers to financial intermediaries to borrowers is only one part of the total savings flow; the other portion travels directly from savers to borrowers in the form of mortgages, bonds and other financial instruments directly acquired.

The proportions of total credit flows moving directly rather than through intermediaries, and the proportions accounted for by the different types of intermediaries, can and do change markedly from time to time. In recent years, the lion's share of total flows has been through the intermediaries, and within this group the banks have done extremely well, mainly reflecting higher rates of interest paid on time and savings deposits since the beginning of 1962. Greater competitiveness in the savings area accounts for much of the 8 per cent annual rate of increase in total bank loans and investments over this period. But commercial banks also have a unique characteristic not possessed by other financial intermediaries; given the necessary reserves, they can create credit to supplement the flow of savings. This is reflected mainly in the growth of checking account balances, which have increased at an annual rate averaging 2-1/2 per cent since 1961.

This monetary growth represents but a small part of the total flow of funds through credit markets. But its importance is much greater than is suggested by the mere dollar amounts involved, because of the credit

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

creation feature. If monetary growth were to be accelerated during a period of vigorous economic activity, with a view to holding interest rates down, for example, the result might be that the additional dollars pouring into the spending stream would mainly tend to raise average prices. This process of monetary inflation would generate expectations of further inflation and thereby tend to increase borrowing and discourage saving. In the long run, monetary policy can contribute to a lower level of interest rates by maintaining a stable value for the dollar. Only in such a climate of confidence will savings accumulate and credit flow in an orderly and expanding volume. In short, Federal Reserve actions cannot for long bring about rates of interest that are either higher or lower than those that balance savings and investment.

This brings me to the role of the Federal Reserve System, which is this country's central bank and, accordingly, an institution to which member commercial banks can turn when funds are not otherwise available. The System discharges its monetary role by keeping the reserves supplied to the commercial banks to support checking account balances in tune with the needs of the economy. At some seasons and in some phases of the business cycle the realities of the economic situation call for more bank credit or the reverse. To induce the banks to increase or diminish the volume of bank credit, the Federal Reserve System adjusts the amount of reserves supplied to them.

By releasing or absorbing bank reserves, the Federal Reserve influences short-term and, to a lesser extent, long-term interest rates. But inasmuch as bank credit is only a portion of the total supply of credit and savings, the influence of the central bank on money rates is marginal. Many factors determine

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

credit conditions, trends and rates. On the supply side these include the volume of savings and the forms which those savings take. On the other side are the kinds and volume of debt instruments issued by the U. S. Treasury and other borrowers,--in short, the nature and extent of demands for credit by its users.

Reflecting the growth of our economy and the scale of its operations, a truly mammoth increase has taken place in total savings and credit flows in recent years. The total of credit funds obtained by the nonfinancial sectors of the economy, for example, amounted to $59 billion in 1962, $64 billion in 1963 and more than $68 billion at annual rates in the first half of the current year. Financial saving has been equally large, and often has tended to outrun even these gigantic credit demands. The result is that funds have been readily available, for virtually all purposes, on liberal terms and at relatively moderate rates, throughout the current business upswing. In fact, it has seemed to some that terms might be too liberal and credit too readily available in certain areas for the preservation of the quality of credit.

The continued ready availability of credit funds during the current economic expansion has differed from that of earlier ones, when credit tended to tighten and its price to rise as the business upswing progressed. Another difference this time is that the flow of savings to financial institutions, and thus the capacity of these institutions to accommodate credit demands, has been very large, while direct investment by savers in stocks and bonds has remained relatively moderate.

The better showing of financial institutions in this cycle basically reflects their improved competitive position in terms of interest rates. Most commercial banks, and many other institutions, raised the rates

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of interest paid on savings accounts early in 1962, when the Board raised ceilings for member banks under Regulation Q. These higher rates proved a powerful attraction for the saving public, as returns available on direct market investments continued relatively low. For commercial banks, the influx of funds has been especially large, as corporations and other large short-term investors have acquired negotiable certificates of deposit in preference to Treasury bills and other money market securities. As a result, bank deposit growth in the last several years has been heavily concentrated in the time and savings deposit area, accounting for more than four-fifths of the expansion in total private bank deposits. This in turn permitted banks to increase their loans and investments by $20 billion in 1962 and 1963, and at close to this rate in the first half of 1964.

Reserves have been needed to support the rapid growth in time deposits--though such requirements are much lower than for checking accounts--and the Federal Reserve has provided these reserves. In this sense, as well as through the gradual increase permitted in checking account balances, the monetary authority has accommodated the growth in credit on liberal terms. Without the reserves that were provided, there could not have been so much of an expansion of bank deposits or so full an accommodation of bank credit demands. Thus, monetary policy can be said to have remained "easy," in furtherance of the national objectives of maximum growth in employment and in the economy, at relatively stable prices. At the same time, the constraint of a continuing large balance of payments deficit prevented any move toward even greater ease, and short-term interest rates have been permitted to work upward in order to maintain a reasonable parity with money rates available on short-term investments abroad.

The principal consideration permitting continued monetary ease is that the current expansion has exhibited characteristics that are different from previous ones. Wholesale prices have remained remarkably stable,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

reflecting a number of factors not present in the middle 1950's, or in 1959. One is the absence of inventory speculation. With prices stable and production capacity ample, purchasing agents have been able to rely upon assured supplies of materials. Another very favorable factor has been the continued rapid increase in productivity per man hour. On the basis of earlier cyclical experience, one would have expected improved productivity only during the first year or so of recovery and then a tapering off. But productivity has continued to rise at about a 4 per cent rate in manufacturing, even though the current expansion has continued for over three and one-half years. The result, in combination with moderation in wage rate advances, has been to keep unit costs and prices stable. Whatever be the underlying cause of this fortunate outcome, it has served to enhance the competitiveness of American firms relative to those abroad.

No discussion of the role of credit in the marketing of goods and services would be complete without the mention of consumer credit. In this country and now increasingly in others, consumer credit provides the mass financing needed to market goods and services, even while it mortgages the future incomes of individuals. It permits people to acquire what they want earlier than otherwise. Not all types of financing take care of the timing problem so neatly. There is a story of a gentleman who longed for a purple Cadillac, but was unable to save the down payment. Finally he took out a life insurance policy whose proceeds, when the fatal day came, enabled his friends to acquire the Cadillac for him to be buried in. As it was being lowered into the grave with the deceased reclining in the back seat, a friend observed, "Man, that's living!"

The aggregate of consumer credit now totals more than $70 billion. In the past year the total has risen by about $7 billion--roughly 10 per cent.

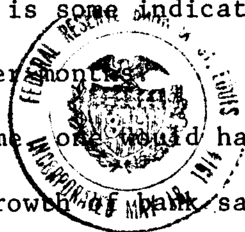
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

And mortgage debt on American homes has also mounted rapidly, to over $190 billion currently, so that the total debt of American households has now passed the quarter of a trillion dollar mark. Annual repayments of consumer instalment debts alone amount to 14 per cent of total personal incomes after taxes. Since only about half of all families appear to have instalment debt, it is evident that such families are, on the average, devoting more than a quarter of their disposable incomes to instalment payments.

One of the most significant aspects of consumer markets relates to the great strength and resilience of consumer expectations. Underlying the persistent optimism of consumer psychology is the confidence of employees in continued job security plus the sense of well-being generated by rainy day funds and other savings. Such considerations, and even relatively minor changes in them, affect the willingness of people to spend from current incomes and to borrow on the basis of future prospects.

This brings us to the question of disposable incomes and especially to the influence of the recent tax cut. Personal income after taxes in the U. S. is more than $430 billion or about $2,250 per capita. The total rose nearly $12 billion between the first and second quarter of this year, partly because of the tax cut. But of this increase, only about half was spent; the rest has been saved. Personal saving relative to income jumped from 7 per cent in the pre-tax-cut first quarter to 8.2 per cent in the post-tax-cut second. This may be just a temporary phenomenon, however. As consumers become accustomed to a little fatter take-home pay, they are likely to increase their spending, and there is some indication that this adjustment has been occurring during the summer months.

In the meantime one would have expected the additional savings flow to have caused rates of growth of bank savings accounts, and savings and loan


LIBRARY

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

shares, to accelerate even faster than in 1962 and 1963. But this does not appear to have been the case. Although growth in savings accounts at institutions was well sustained through the spring, the failure of flows to rise suggests that individuals preferred "do-it-yourself" saving to an increasing extent. They paid off some debt, and bought securities (especially the AT&T stock issue). The point is they acted directly rather than turning their funds over to intermediaries, with the result that the saving process in which financial intermediaries had come to play such a large role became partly "de-institutionalized."

<u>Summary</u>

To sum up, credit has long been recognized as an important marketing tool, hence its cost and availability are of concern to marketing executives. In general, credit has become more available to more people and for far more purposes as the economy has developed. Large-scale entrance into the consumer-credit field by commercial banks since World War II, combined with continued evolution of the specialized lenders, such as finance companies and credit unions, has greatly enhanced the availability and terms under which credit is supplied to consumers. Similarly, business credit has taken new and enlarged forms, as companies have formed credit subsidiaries to finance their dealers, as the use of trade credit as a sales device has been expanded, and as banks and other lenders have continued their aggressive effort to obtain new customers, in part by merchandising credit.

This discussion, however, has been focused upon the cyclical behavior of the cost and availability of credit. In past business expansions, credit generally has come to be in short supply and its cost has mounted. But in the current expansion which has now been under way for more than three years, credit has continued to be readily available and its cost has

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

risen very little from the recession lows. Why has this been so? Essentially the answer is that saving has continued unusually large, while demands for borrowed funds have not pressed strongly against the enlarged supplies available. And the Federal Reserve has been able to contribute to the ready availability of credit in view of the continued existence of unused resources--manpower and production capacity--and the continued absence of general inflationary pressures.

Despite sizable and extended gains in activity, the economy's performance has generally been marked by moderation--reasonableness in pricing policies, prudence in family budgeting and in business investment programs, and restraint in inventory management. Basically, it is this pervasive influence of moderation that has made possible the stability of interest rates and continued ready availability of credit.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis