BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

August 2, 1948.

STATEMENT OF GOVERNOR R. M. EVANS,
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
BEFORE THE
BANKING AND CURRENCY COMMITTEE OF THE HOUSE OF REPRESENTATIVES

REGULATION OF CONSUMER INSTALMENT CREDIT

FOR RELEASE UPON DELIVERY

BOARD OF GOVERNORS
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REGULATION OF CONSUMER INSTALMENT CREDIT

The Board of Governors of the Federal Reserve System on several occasions in the past has recommended to the Congress legislation which would authorize the regulation of consumer instalment credit. This is the sector of consumer credit which has been subject to wide fluctuations in the past, thereby contributing to instability and unemployment. The Board believes that measures permitting the moderation of these fluctuations, which are tending to increase in size and influence, are an essential part of a program to achieve stable production and employment at maximum levels, a declared national goal of this country.

The Congress has before it at this time a resolution which would restore, in so far as instalment credit is concerned, the authority that was exercised from 1941 to 1947 through Regulation W. This would be a temporary measure designed to help meet the special inflationary pressures which exist today. The Board's opinion is that, while permanent legislation would be preferable, conditions are such as most urgently to require action and a temporary measure is better than none. To have any real usefulness, however, the authority should be provided for a sufficiently long period so that persons subject to regulation will realize their responsibility and adhere to its provisions. For this reason, we believe that any legislation on this subject should extend at least until June 30, 1950. During this period, of course, the Board would be able to modify the regulation to meet changing conditions.

Regulation under the proposed legislation would be in much the same form as it was under the Board's Regulation W when that was last in force. It would cover instalment credit, not only instalment credit for financing the purchase of consumers' durable goods but also instalment credit for other consumer purposes, both of which are inflationary under present conditions. It would prescribe maximum maturities and minimum down payments as did Regulation W, but not necessarily at the same levels. The proposed legislation includes provision for more appropriate enforcement machinery than was available under Executive Order No. 8843 which authorized Regulation W. Courts of equity would be empowered to aid enforcement by enjoining violations, as provided in legislation dealing with similar matters.

The case for this legislation seems to the Board to be particularly strong in the light of the general conditions which now exist. During the three years that have elapsed since V-J Day, the American public has gone into debt more rapidly than in any other period in our history. At the same time consumers in general have been fully employed, have received a record amount of income, and have continued to increase their exceptionally large holdings of liquid assets. The large volume of consumer spending from current incomes, rapid turnover of accumulated savings, and increased borrowing, accompanied by limits on output of goods and services, have contributed to the upward spiral of prices.

Consumer credit consists of both instalment credit and single-payment credit. Wide fluctuations in the total volume of consumer credit over the years have reflected principally changes in instalment credit. The importance of these changes is indicated by the chart. The 1942-43 decline in this type of credit accounted for more than 85 per cent of the decline in total consumer credit, while the postwar rise in instalment credit accounted for 60 per cent of the total rise. Other forms of consumer credit fell very little in the early war period and began to increase earlier than instalment credit. Their greatest growth occurred in 1946, and in recent months a tendency to level out has appeared. Instalment credit, on the other hand, has continued upward.

Instalment credit outstanding rose 2.3 billion dollars from June 1947 to June 1948, about 15 per cent more than the 2 billion dollar increase of the previous 12 months. The rate of advance appeared to be falling off in the first quarter of 1948, but in the second quarter there was a pick-up in activity and the net gain in outstanding credit was again 15 per cent above that of the corresponding period of the previous year.

An indication of the increasing frequency of the use of instalment credit is given in the Consumer Finances Survey made for the Board of Governors. The information was obtained by interview of a selected sample of consumer spending units in the country, each unit being a group of persons in the same family and dwelling who pool incomes to meet major expenses. Data from the survey show that one out of every four consumer spending units, or approximately 12 million spending units, bought on the instalment plan (instalment sale credit) in 1947 as compared with a ratio of one out of every seven or eight in 1946. Instalment loans at banks, loan companies, credit unions, and other such agencies were obtained by 15 per cent of all consumer spending units in 1947 (7 million spending units) as compared with 13 per cent in the preceding year. There was some evidence to indicate that the new users of such credit were concentrated in the middle and upper income classes, principally those with incomes of above $3,000 a year.

Reports on instalment buying terms throughout the country indicate that when Regulation W was terminated many credit grantors adopted credit policies that were considerably less restrictive than those required by the regulation but somewhat more restrictive than those prevailing before the war. In recent months there has been a further relaxation in the down payment and maturity requirements in instalment credits for practically all categories of durable goods. Competition has been the primary factor leading to lower down payments and longer maturities; when one important retail outlet in a community relaxed terms, other stores soon felt that it was necessary to follow.

The prospect for the balance of this year is for increased use of consumer instalment credit, further reduction in down payments, and lengthening of maturities. Together with the seasonal rise in the use of instalment credit during the late months of the year, these factors suggest a growth exceeding that which occurred in the first six months.

The increase in instalment credit this year is of special significance because it is taking place notwithstanding the fact that the output of consumers' durable goods is no longer growing. With a rise of 85 per cent in durable goods in 1946, there was an increase of 65 per cent in instalment credit. In 1947 the percentage increase in instalment credit of 55 per cent accompanied a growth of but one-third in durable goods. Gradually, the increases in credit have outstripped the expansions in output of goods. By the middle of 1947, durable goods production had stabilized at a level that has been maintained up to the present time. Yet instalment credit continued to rise -- one billion dollars for the first six months of 1948 and more in prospect.

In view of the current tight situation in supplies of labor and materials, further expansion of instalment credit can neither increase output nor put more people to work. It can only add more purchasing power to the already swollen spending stream and reinforce inflationary pressures. International developments, moreover, inevitably add pressures in the markets for consumers' durable goods.

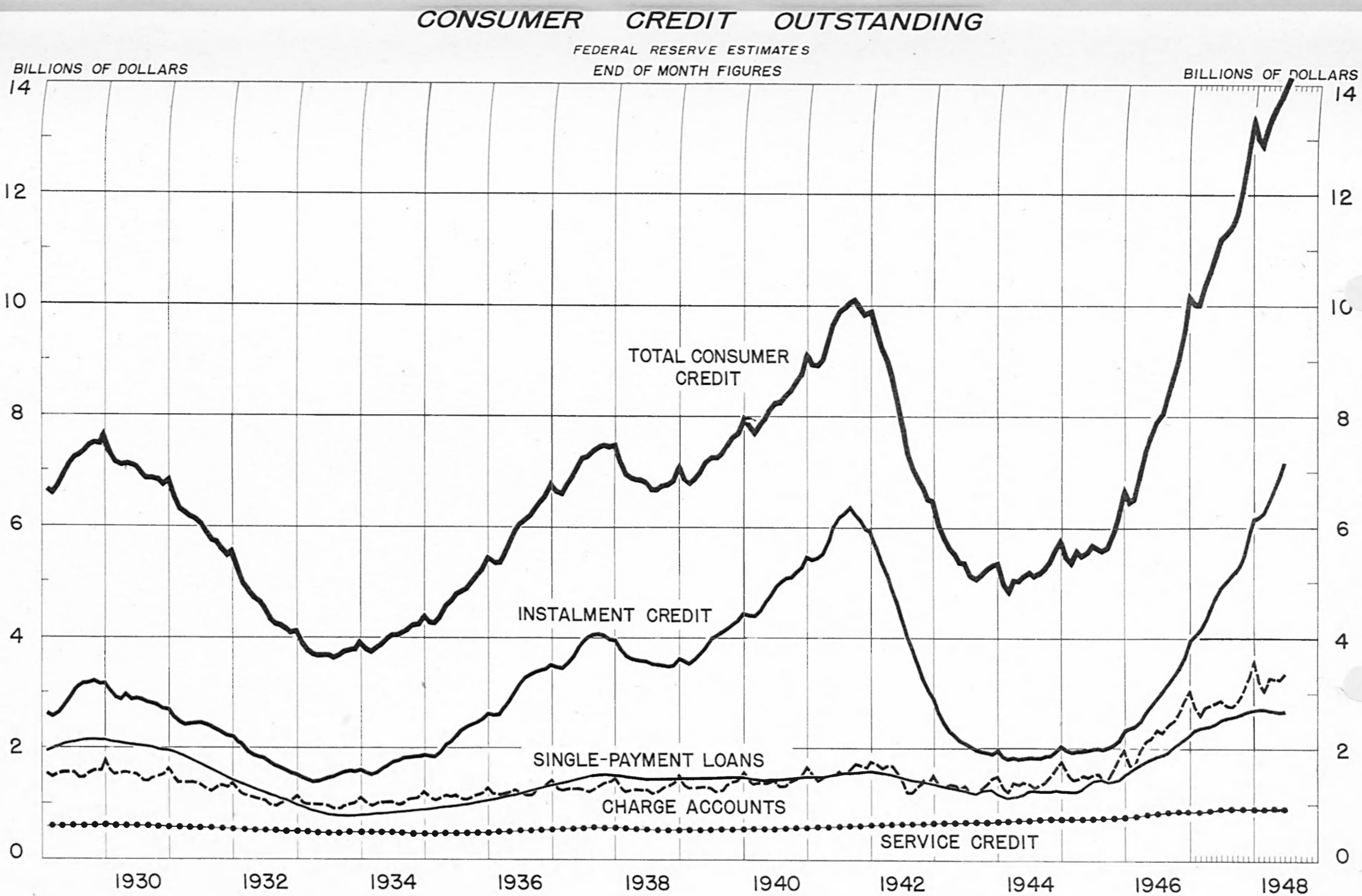
Because more purchasing power is being added to a supply of funds already excessive in relation to available goods, expansion of instalment credit under present conditions is of an inflationary character irrespective of its relative level as compared, for example, with national income. While credit outstanding now amounts to no more than 3.9 per cent of annual disposable income in the United States, as compared with a range of 5.5 per cent to 7.1 per cent in the years just preceding the war - the highest levels on record - conditions today are much different. In the year 1940, for example, when the percentage was at its peak, average unemployment was 14.5 per cent of the total labor force, according to the Bureau of Census estimates, as compared with 3.5 per cent in 1947. In other words, there is no slack today. More credit cannot call forth more goods - it can only add to the upward pressure on prices.

It should be noted that the Board's position on regulation of instalment credit is not to be taken as in any way indicating a feeling that all instalment credit is undesirable. The problem is to prevent the abuse - not the use - of credit. A damping of disruptive fluctuations is what we are interested in, and more stability at levels related to the conditions of the time.

Since the end of Regulation W a number of trade associations of credit grantors have urged their members to exercise caution in liberalizing terms and expanding portfolios. Such efforts have undoubtedly had some effect in moderating the increase in instalment debt. These voluntary efforts, however, have not succeeded in preventing gradual reduction in the down payments and lengthening of the maturities advertised by credit grantors. Easy terms are rapidly approaching those which were offered before the war.

Now is the time when it is in the best interest of all consumers to save more and spend less. This is the time to reduce - not to increase - debt. This is a time for restraint - voluntary, yes, but reinforced, much as we all dislike compulsions, so far as necessary to protect the real interests of all of us.

Finally, the Board has asked me to reiterate as strongly as possible that regulation of instalment credit is a tool - but only a supplementary tool - for dealing with the problem of inflationary credit. By itself it cannot do the job. To be adequately effective, it must be buttressed by the basic bank credit controls which the Board has advocated repeatedly, beginning with its 1945 annual report to Congress.



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